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Canada. Royal commission on banking and finance.

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Royal Commission on Banking and Finance

LORD COBBOLD

Hearings
held at
OTTAWA

Vol.

34

Date.

10 SEPT. 1962



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Toronto, Ont.



Nethercut & Young
Toronto, Ontario

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-3957-

ROYAL COMMISSION ON BANKING
AND FINANCE

---At 9:30 A.M. THE HEARING RESUMED BY STATE IN LAW

THE CHAIRMAN: We will now call the meeting

to order.

Hearings held at Ottawa, Ontario,
on Monday, September 10th,
1962.

This morning we have a submission from

Lord Cobbold, formerly Governor of the Bank of England.

I wish to welcome you this morning to the hearings

of our Commission. We are very much indebted to you

THE COMMISSION

for coming to this commission for this purpose especially

and to look forward with great interest to a discussion,

The Honourable Dana Harris Porter

Chief Justice of Ontario

Toronto, Ontario

- Chairman

Mr. W. Thomas Brown, M.B.E.

Investment Dealer,

Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.

Banker

Toronto, Ontario

Mr. Gordon L. Harrold

Agriculturalist

Calgary, Alberta

Mr. Paul H. Leman

Corporation Executive

Montreal, Quebec

Mr. John C. MacKeen

Corporation Executive

Halifax, Nova Scotia

Dr. W.A. Mackintosh

Vice-Chancellor

Queen's University

Kingston, Ontario

If I might make one or two general

Mr. H.A. Hampson

- Secretary

Mr. Gilles Mercure

- Joint Secretary



Metropolitan & Young
Toronto, Ontario

-3957-

ROYAL COMMISSION ON BANKING
AND FINANCE

Hearings held at Ottawa, Ontario,
on Monday, September 10th,
1952.

THE COMMISSION

The Honourable Dana Harris Foster
Chief Justice of Ontario
Toronto, Ontario
Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer,
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
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Dr. W.A. Mackintosh
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Ottawa, Ontario
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THE CHAIRMAN: We will now call the meeting
to order.

This morning we have a submission from
Lord Cobbold, formerly Governor of the Bank of England.
I wish to welcome you this morning to the hearings
of our Commission. We are very much indebted to you
for coming to this country for this purpose especially
and we look forward with great interest to a discussion,
which no doubt will ensure, from the submission which
you have placed before us.

Perhaps you would prefer at the outset
to make a few remarks by way of introduction to the
subject matter and, of course, our usual practice is
to put questions to you on various phases of the
subject and perhaps we may just as well proceed now.
You may be seated, or you may stand, as you wish;
these proceedings are very informal.

LORD COBBOLD: Thank you very much,
Mr. Chairman and members of the Commission.

I take it as a great compliment that you
have invited me to come here and appear before the
Commission and I shall be only too anxious to give
you any assistance that is in my power.

If I might make one or two general
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September 10, 1949

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This morning we have a submission from

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I wish to welcome you this morning to the hearing.

We are very much indebted to you

for coming to this country for this purpose especially

and we look forward with great interest to a discussion,

which no doubt will enliven the submission which

you have placed before us.

Perhaps you would prefer at the outset

to make a few remarks by way of introduction to the

subject matter and, of course, our usual practice is

to put questions to you on various phases of the

subject and perhaps we may just as well proceed now.

You may be seated, or you may stand, as you wish;

these questions are very important.

LORD GORBOLD: Thank you very much.

Mr. Chairman and members of the Commission.

I take it as a great compliment that you

have invited me to come here and appear before the

Commission and I shall be only too anxious to give

you any assistance that is in my power.

If I might make one or two general

observations before we get down to the business of

the morning, I would like just to recall to you, sir,



1 that I have been out of this trade for more than a year,
2 and am therefore rather rusty on the subject, and you
3 will forgive me if I am not quite up to date in any
4 comments on current affairs, because honestly since
5 the end of June of last year I have not been following
6 these matters as closely as I did in the preceding
7 20 or 25 years.

8 Secondly, I would just like to emphasize
9 that I shall be speaking throughout with reference
10 to the Bank of England and to United Kingdom market,
11 and although I have been fortunate enough to enjoy
12 very close contacts with the Bank of Canada for 25
13 years or so, and have thus followed the Canadian
14 scene from a distance, I lay no claim to intimate
15 knowledge of Canadian banking or financial markets;
16 I should therefore not presume to offer advice ,
17 comment or criticism on Canadian affairs. I
18 would therefore ask the Commission to remember that
19 in anything I say on the technical subjects I shall
20 be speaking from the London angle in terms of United
21 Kingdom conditions, in terms of the arrangements
22 which govern sterling in the United Kingdom markets
23 and in full recognition of the fact that in both
24 technical matters and in more general questions of
25 set-up and relationships there are very many differences
26 between Canada and the United Kingdom.

27 It will therefore be necessary to make
28 every sort of qualification and reservation when
29 translating any views which I may express into terms
30 of the Canadian scene.



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It will therefore be necessary to make every sort of qualification and reservation when translating any views which I may express into terms



1 Finally, it will I am sure be obvious
2 to you, sir, and to your colleagues and I would like
3 to make it clear for the record, that any views I am
4 expressing are entirely my own personal views and
5 do not in any way reflect the views of the institution
6 of which I was previously governor.

7 I propose, sir, to divide what I have to
8 say into five sections, on which I sent you a brief
9 note. Your secretary was good enough to give me
10 a general indication of the points which he thought
11 the Commission might like to hear from me as a
12 visitor from Overseas, and I would propose to take
13 the points which he underlined first, and they,
14 by and large, cover the organization and set-up of
15 the Bank of England, the relations of the Bank of
16 England with Her Majesty's government and the relations
17 of the Bank of England with the banking and financial
18 community in the United Kingdom. I would, sir, if
19 this is convenient, take these three different things
20 separately, and would suggest that the Commissioners
21 might care to ask me questions on any of these. I
22 would then pass to what are more general points; the
23 general effects of monetary policy on the domestic
24 market and, lastly, the inter-relation of monetary
25 policy with the Overseas side of things, the balance
26 of payments, et cetera, and the contribution which
27 Central Bank co-operation can make in the general arena
28 of financial co-operation.

29 As I say, I have understood that the
30 Commission would particularly like to hear from Overseas



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As I say, I have understood that the



visitors like myself something about the organization and set-up in our own markets. I would like also to make this general observation; I have felt it would be more convenient to you -- and I gather that is your view, sir -- I shouldn't put in a great deal of material because I wasn't absolutely certain what sort of material would be of most use to you, nor do I intend to make statements at any length, and I think it may be easier for you to get at what you want by the method of question and answer.

I would, however, say this; I think there may be some things which come up in the course of our discussion on which you would like to have a more considered view than I could give quickly this morning; if that is so, I would be most happy if that would suit your convenience, and that of the Commissioners, to send in a memorandum or notes at a later stage giving a more considered view.

May I then start on the first of the five?

THE CHAIRMAN: The first of the five, the organization of the Bank of England; qualifications and functions of the court of directors; the role of the committee of the treasury and the relations between the governor and the court.

Would you like to make a statement on that point first, before questions are put?

LORD COBBOLD: I think that would perhaps be convenient, sir. If I may start by saying that the bank is a very old institution, dating from 1694. The development into a modern central bank has been a



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LORD CORBET: I think that would be

be convenient, sir. If I may start by saying that

the bank is a very old institution, dating from 1694.

The development into a modern central bank has been a



1 gradual process over the centuries and the United
2 Kingdom financial machinery has grown and developed
3 with and around the Bank of England. It is this
4 gradual development and historical background which
5 explains many of the practices and relationships of
6 the London market, many of which derive from traditions
7 and unwritten laws which are not applicable to markets
8 where the development has been quicker or more recent.

9 I emphasize this because this fact
10 differentiates the practice in London from the practice
11 in other centres, and it is one of the reasons why
12 I say that one cannot too easily translate what
13 we do into terms of what other people either do
14 or should or should not do. It has always been
15 the endeavour of the Bank of England to retain what
16 is useful in tradition and in recognized practice, but
17 at the same time to develop and to modernize.

18 I say this to emphasize once again that
19 I am very far from suggesting that the Bank of England
20 and the London set-up would necessarily be generally
21 appropriate or convenient for Canada. Although, as
22 I say, there have been constant changes in development,
23 the two biggest changes in the Bank of England
24 structure came in two stages; the first around the
25 turn of the century when the bank gradually withdrew
26 from commercial business. As you will know, sir,
27 for the first two hundred years, it was a highly
28 competitive commercial bank and it was in the late
29 eighteen hundreds and the early nineteen hundreds when
30 the bank decided that they would be better out of



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the two biggest changes in the Bank of England structure came in two stages; the first around the turn of the century when the bank gradually withdrew from commercial business. As you will know, since the First World War, the bank has been a purely monetary and financial institution. The bank decided that they would be better off of



1 competitive commercial business, and it was only by
2 withdrawing from commercial business that they could
3 gain the confidence of the banking community and act
4 as a modern central bank.

5 The second change has taken place in the
6 last thirty years, largely corresponding with the
7 much greater activity of government in the financial
8 business which has, of course, in terms of the long
9 historical background altered the basis of relations
10 between the Central Bank and the government.

11 I say that change has taken place over
12 the past thirty years, but I think I should specify
13 a little more. The first real change was in 1931,
14 and the years immediately before and immediately
15 after when the exchange equalization account was
16 set up and Her Majesty's government more or less took
17 direct responsibilities for the foreign exchanges
18 and, as you will know, the Bank of England has through-
19 out acted as the advisor and operator of the exchange
20 equalization account although the responsibility and
21 the ultimate decisions have lain with Her Majesty's
22 government.

23 The second big change took place on the
24 outbreak of war in September, 1939, with the setting
25 up of the exchange control, which was administered
26 by the Bank of England for the account of Her
27 Majesty's government and with the general
28 concentration of financial and banking arrangements
29 in the United Kingdom for the prosecution of the
30 war effort, which brought both the government and the

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1 central bank into very much closer contact and gave them
2 much greater responsibility for the financial
3 mechanism than they had before.

4 The third change was, of course, the
5 Nationalization Act of 1946, to which I will refer
6 in rather more detail a little bit later. The
7 present court of directors consists of 16 directors,
8 plus the governor and deputy governor. All eighteen
9 are appointed by the Queen which, of course, means
10 on the advice of the Prime Minister and the government
11 of the day. There is no formal representation of
12 particular interests; that is to say, there has never
13 been any suggestion that industry should nominate
14 a member or shipping should nominate a member, or
15 that the trade union council should nominate a member.
16 The objective has been to get the best men available
17 for the court of directors covering a wide cross-
18 section and making sure that there is adequate
19 representation, not only on banking and finance, but
20 on industry, shipping, commerce, insurance, et cetera,
21 and the trade unions.

22 The practice has been
23 that directors have been appointed often by one
24 administration for a four year term, and have more
25 or less regularly been re-appointed by the same
26 administration or by the administration in power
27 at the time of re-appointment, and we have for long
28 had a voluntary age limit of 70, and by and large
29 the practice has been that people stay on and move
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at when they are at or nearing the retiring age.



1 Of the 16 directors, four can be appointed
2 by the court -- and this is an important point --
3 as executive directors, and they take charge under
4 the governors of the different activities of the bank.
5 The court also appoints the committee of the treasury;
6 that is an ancient name and sometimes causes some
7 confusion because it suggests in many people's
8 minds a connection with Her Majesty's treasury or
9 the government.

10 Of course, that is not at all the case;
11 the committee of treasury is an executive committee
12 of the court, entirely elected by the court, which
13 the governors notify and consult in considerably
14 more detail than it is practical to do with a court
15 of 18 members. Both the court and the committee
16 of treasury meet once every week and occasionally,
17 in times of particular preturbation, the committee
18 of treasury will meet more often than that, either
19 formally or informally.

20 I think it would be convenient, sir, to
21 just put on the record something which I sent to you
22 and which represents a statement which I made on this
23 subject to the Radcliffe committee at the time, and
24 which still represents the opinions which I hold.

25 Would you ask, sir, whether I am audible
26 in the room?

27 THE CHAIRMAN: Unanimously, yes.

28 LORD COBBOLD: The first responsibility
29 for formulating policy, for tendering advice to
30 Her Majesty's government and for market operations,



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1 naturally falls on the governors. They have at their
2 disposal advice and assistance from the executive
3 directors and the permanent staff of the bank, but
4 under the present system they also have a great
5 advantage of being able to consult the part-time
6 directors individually or collectively on general
7 or particular matters with secrecy and continuity
8 and with the directors knowing they may have to
9 share responsibility for decisions which are based
10 partly on the views which they individually express.

11 The directors of the bank cover between
12 them a very wide range of interests in banking,
13 industry, commerce, trade unions, shipping and
14 insurance. They are all practical men with a wide
15 and up-to-date knowledge of events at home and abroad,
16 and it is quite invaluable to the governors to be
17 able to draw from this fund of knowledge and experience
18 in formulating and executing policy and in tendering
19 advice to the government.

20 The functions and responsibilities of
21 the part-time directors vary in the different activities
22 of the bank. There is no field in which general
23 knowledge of their views and even particular consultation
24 is not of benefit to the governors; particularly in
25 the domestic affairs of the bank both on the court
26 and in sub-committees they play a very active and
27 continuous role.

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and in sub-committees they play a very active and

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1 In the field of monetary policy the court is
2 directly concerned with matters which are the bank's
3 immediate responsibility. On the general control of
4 the money market, although no formal decision is asked
5 of the court except in the matter of bank rate where
6 they make a formal decision, reports are regularly given
7 to the court or the committee of treasury and it is
8 open to either body to query the governor's policy.

9 The court are not especially concerned with the
10 bank's activities in foreign exchanges where the bank
11 acts as agent for Her Majesty's treasury and where no
12 statutory obligation lies on the bank, but here, again,
13 as in other activities of the bank, the governors
14 continually bear in the mind the general views of their
15 colleagues, and frequently ask for individual or
16 collective opinions on particular situations.

17 The strength and independence of thought of the
18 Bank of England derives largely from a court constituted
19 on the present lines taking an active and continuous
20 part in forming policy. The bank owes much of its
21 standing, and the confidence which it enjoys at home
22 and abroad, to the knowledge that the actions taken
23 by the governor have the support of the wide experience
24 of the court of directors. If the nature of the court
25 were to be altered so that it were not to be composed
26 of active practical men of business, or if the directors
27 were to become mere figure-heads divorced from the
28 real affairs of the bank, the standing of the Bank of
29 England and its ability to perform its public duties
30 would both be gravely prejudiced.



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real affairs of the bank, the standing of the Bank of

England and its ability to perform the public duties

with which it is charged would be greatly weakened.

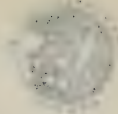


1 I think, sir, that concludes what I have
2 to say initially on the first part.

3 COMMISSIONER BROWN: Lord Cobbold, I wonder
4 if I may ask you one or two questions in detail on
5 this. These are things that you know about and which
6 we do not. I wonder if you could tell us something
7 about the recruitment and appointment of the executive
8 directors. Do they come up from within the bank itself,
9 or do they come from outside?

10 LORD COBBOLD: Either way, sir. This, of
11 course, is a rather modern development, and I would
12 almost say that the bank is still feeling its way in
13 this matter. I am not absolutely certain of my dates
14 but, by and large, there was one executive director
15 dating from about 1915 or 1916, and then this post fell into
16 abeyance again. There was another executive director
17 appointed in about 1933, and I think two more were
18 appointed in 1938, of whom I was one. In the last
19 15 years it has become more or less established that
20 there should be four. The statutory rule is that the
21 court may elect up to four executive directors. Of
22 the present four executive directors two have been on
23 the staff of the Bank of England throughout their lives.
24 One came in as an adviser some 15 years ago. He was
25 originally a member of the Indian Civil Service and
26 was secretary to the Viceroy and he joined us after
27 that, so that the origins of his career were outside
28 but he had eight or nine years inside the bank before
29 he became an executive director.

30 The fourth also had some outside experience



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course, is a rather modern development, and I would almost say that the bank is still feeling its way in this matter. I am not absolutely certain of my dates

but, by and large, there was one executive director dating from about 1915 or 1916, and then this year 1921

apexed again. There was another executive director appointed in about 1933, and I think two more were

appointed in 1938, of whom I was one. In the last 15 years it has become more or less established that there should be four. The statutory rule is that the

court may elect up to four executive directors. Of the present four executive directors two have been on

the staff of the Bank of England throughout their lives. One came in as an adviser some 15 years ago. He was

originally a member of the Indian Civil Service and was secretary to the Viceroy and he joined as after

that, so that the origins of his career were outside but he had eight or nine years inside the bank before

he became an executive director. The fourth also had some outside experience



1 in legal fields and had a distinguished war career.

2 He came into the bank into the fairly high ranks on
3 the advisory side immediately after the war.

4 I think you could say that the general
5 practice -- and I would not wish this to be any sort
6 of commitment, but the general idea, certainly in my
7 mind during my governorship, was that of the four
8 executive directors the ideal was that two should be
9 professional banking men and the other two should come
10 in from outside, and perhaps one, or both of them,
11 should have had a considerable initial period in banking
12 before they came into the court. However, I would by
13 no means exclude the possibility that one, or possibly
14 two, executive directors might come in straight from
15 outside, and, indeed, in the case of the first director
16 of the present regime who came in in 1933, he did come
17 in directly from outside. There is no rule about it.
18 The bank is feeling its way, but that, I would say,
19 is the general practice and the general theory.

20 COMMISSIONER BROWN: Do they individually
21 have responsibility for particular departments of the
22 bank?

23 LORD COBBOLD: There again that is, to some
24 extent, experimental and very flexible. The arrange-
25 ments in recent years and during my time were that two of
26 the executive directors were generally responsible for
27 overseas matters. One was responsible for internal
28 monetary matters and contact with the markets, and
29 one was responsible for departmental and staff questions,
30 but, that, as I say, is flexible. There is nothing laid



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1 down on that, and it could be developed or changed as
2 conditions and other matters develop.

3 We have had, as I say, two on overseas
4 exchange matters in recent years because that has
5 been such a very important side of our activity, and
6 we have found in practice that one of them is almost
7 always overseas, and we need two of them in order to
8 have someone regularly at base. During the war the
9 arrangement was slightly different. During that time
10 there was not the same need for travel, or the possibility
11 of it. I was myself the executive director in charge
12 of the overseas and exchange part of the bank during the
13 war, and at that time I was the only one on the overseas
14 side. Actually, we had only three executive directors
15 during the war period.

16 COMMISSIONER BROWN: With respect to the
17 part-time directors I gather that they work at different
18 duties as well as being members of the board?

19 LORD COBBOLD: Yes, certainly. We have a
20 general rule that on all committees there is a majority
21 of part-time directors, so that we keep the influence of
22 the court very closely at work on these committees.
23 They are mainly connected with the internal administra-
24 tion of the bank, with the exception of the committee
25 of treasury.

26 For example, there is a staff committee,
27 an audit committee, a committee for the control of
28 expenditure, an investments committee, and so on.
29 That is mainly concerned with what
30 we would call the housekeeping of the bank in which it



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1 has always been the bank's tradition that the outside
2 directors should keep a very firm hand on that side
3 of the business.

4 We do not have formal court committees on
5 such things as monetary policy or the exchanges, and,
6 as I said in my earlier statement, in those matters
7 the services of the part-time directors would be much
8 more directed towards being available to the governor,
9 and the governor would consult any member of the court
10 on any particular matter on which he thinks his opinion
11 would be particularly valuable. Obviously there are
12 some members of the court who are particularly well
13 informed on overseas exchange matters, and it would be
14 normal for the governor to have their views pretty well
15 continuously on that side of the house.

16 COMMISSIONER BROWN: Are the meetings of the
17 court more or less formal?

18 LORD COEBOLD: Very highly formal.

19 COMMISSIONER BROWN: In the sense that it would
20 be unusual for the court not to follow your advice?

21 LORD COEBOLD: Very unusual, but that does
22 not mean that the court are ciphers. The semi-formal
23 or accepted practice is that the court does not over-rule
24 the committee of treasury which is its own executive
25 committee elected from its own members. By and large,
26 if I may use slightly informal parlance, the governor
27 can take it that if he has squared the committee of
28 treasury he will be all right with the court.

29 That is the general understanding, but in
30 any important matter on which the governor felt there were



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COMMISSIONER BROWN: Are the members of the

court more or less formal?

LORD CORBOLD: Very highly formal.

COMMISSIONER BROWN: In the sense that it would

be unusual for the court not to follow your advice?

LORD CORBOLD: Yes, I think so.

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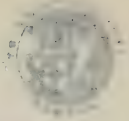
1 likely to be different or conflicting views then,
2 speaking for myself, I would most certainly make
3 quite sure before I took that matter to court that I
4 had the court pretty solidly behind me by discussing
5 matters with them beforehand. The committee of treasury
6 is by no means a formal body, and matters would be
7 discussed very fully, and a very full account taken
8 of the views of the part-time directors on the
9 committee of treasury. Again, as a matter of practice
10 but not of statute, the committee of treasury has
11 always a majority of part-time directors.

12 COMMISSIONER BROWN: Are the executive directors
13 on the committee of treasury?

14 LORD COBBOLD: There is one as a rule, but
15 not more. The governor and the deputy governor are
16 ex officio members of the committee of treasury.

17 COMMISSIONER BROWN: If the meetings of the
18 court are fairly formal what particular advantage do you
19 find in having the executive directors, who are your
20 full-time directors, also members of the court?

21 LORD COBBOLD: More, I think, sir, as a
22 matter of status, really. We try to differentiate as
23 little as possible between executive directors and
24 directors. They are all directors, and we have tried
25 to build up a sense of corporate responsibility. Some
26 of those people take a full-time responsibility and
27 some of them take a part-time responsibility, but they
28 speak to each other as equals. There is no question
29 of the executive directors being officials or being
30 in any way subservient to the directors, and we have



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1 found that practically that is a very considerable
2 corporate advantage. I think I would put it like that.

3 COMMISSIONER BROWN: What I am getting at is
4 if, in fact, the executive directors would not be
5 taking any greater part in the discussion in the formal
6 court meetings than the outside --

7 LORD COBBOLD: Not in the formal court
8 meetings, but, of course, they would be taking part
9 in the discussions day by day with the governors
10 beforehand. I think your point is: Why have them
11 as members of the court and as directors: In the olden
12 days that was not the practice, and then the governors
13 discussed policy with the officials and then took it
14 to the court. As I say, it is largely a question of
15 status both to make the executive director a part of the
16 corporate body of the court and to give him that status in
17 relation with his dealing with other members of the court.
18 I think, perhaps it would help you if I gave a specific
19 instance.

20 For example, an executive director in charge
21 of the foreign exchange under the present arrangements
22 would be perfectly entitled to ring up as an equal three
23 or four of the other directors who he thought knew
24 something in particular about Brazil, or about India,
25 or about Japan, and ask him for his opinion, or to ask
26 him to come in and talk to him as an equal, and not as
27 an official talking to a director.

28 The other side, which is also to some extent
29 a status side, is that it is immensely valuable for
30 the governor to be able to send an executive director over



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COMMISSIONER BROWN: What I am getting at is

it, in fact, the executive directors would not be

taking any greater part in the discussion in the future

court meetings than the outside --

LORD CORBOLD: Not in the formal court

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in the discussions day by day with the members

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The other side, which is also to some extent

a status side, is that it is extremely valuable for

the government to be able to send an executive director



1 to international meetings. We have found that a person
2 who is a member of the court can represent the governor
3 of the bank at meetings of the International Monetary
4 Fund or the European Payments Union, or even in dis-
5 cussions with other central banks and at meetings with
6 other central banks.

7 It gives those persons added standing and
8 authority, and in the present day with one governor and
9 one deputy governor who cannot be rushing around all the
10 time it has helped us enormously to have someone who can
11 speak as a director and not only as an official. That
12 is true also, to some extent, in our London contacts
13 with other banks and in touring around the provinces
14 in England.

15 I do not say the same work could not be
16 done as an official, but we have found it much more
17 practical and a much better arrangement to have people
18 speaking with that added authority, and also people who
19 can discuss matters as equals with their part-time
20 colleagues.

21 COMMISSIONER BROWN: The most notable
22 contrast between the part-time directors of the Bank
23 of England and the part-time directors of the Bank of
24 Canada is in this business of having representation from
25 banking and finance. It is not permitted under the
26 Canadian statute, as you so well know. My understanding
27 is that the practice in England is that you do not have
28 representatives from the clearing banks but you do have
29 them from the merchant banking fraternity. What problems
30 do you have about conflict of interest? Perhaps there



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1 have been one or two matters that have given rise to
2 public discussion recently, but in practice it does not
3 appear to be a serious problem.

4 LORD COBBOLD: In practice, in my experience,
5 I have never found that a difficult problem. As I said
6 in evidence before the Parker Tribunal, in my experience
7 almost everybody has problems of conflict of interest.

8 Anybody who sits on two or more boards
9 of directors quite certainly has a conflict of interest
10 at certain times. Lawyers, again, I think, have
11 different clients, and very frequently I should think
12 they are faced with a conflict of interest. Chartered
13 accountants who know the business of a number of different
14 clients certainly do.

15 My personal experience is that people who
16 have reached the sort of grade that one expects of
17 directors of the Bank of England know very well how
18 to differentiate their interests.

19 On the question of the clearing bank directors
20 it has, as you say, been the general practice not to have
21 directors from the clearing banks, although as a matter
22 of fact there is at the moment one director from one
23 of the smaller clearing banks.

24 That, again, ties in a little bit with the
25 historical background and the gradual development that
26 I was talking about. A hundred years ago the majority
27 of the court would have been from the finance houses,
28 the accepting houses and private banks. The composition
29 of the court has been very much changed since then,
30 and I think that now there are four from the houses



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1 and the majority of the directors comes from industry,
2 commerce and other parts. But, it has grown up to
3 be a tradition that there is a certain amount of
4 accepting house-merchant bank representation on the
5 court, and that has been proved extremely convenient.
6 I would not by any means attempt to lay down a principle
7 that there should never be a clearing bank director
8 appointed. We have felt that on the whole it is easier
9 to deal between the Bank of England and the clearing
10 banks through the chairman of the day of the clearing
11 banks committee, and that it might be embarrassing if
12 Bank X were represented on the court and Bank Y were to
13 provide the chairman of the clearing banks committee.
14 I do not think it would be a great embarrassment, but
15 it seems to fit slightly better that we should have
16 the accepting house people on the court.

17 As I say, I would not attempt to lay down anything
18 definite. We have, in a sense, felt our way by having
19 one member of the court from one of the smaller clearing
20 banks.

21 COMMISSIONER MACKINTOSH: What about discount
22 houses?

23 LORD COBBOLD: We have always made it a
24 definite rule that no member of a discount house should
25 be on the court. There would be a very definite conflict
26 of interest there which would be difficult and
27 embarrassing.

28 THE CHAIRMAN: Are there any further questions
29 on this point?

30 COMMISSIONER GIBSON: Lord Cobbold, I would



and the subject of the Bill is a matter of some importance

and other parts. But, it has grown up to

be a question of some importance

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one member of the count from one of the smaller clearing

banks.

THE CHAIRMAN: I have always said it is

definite rule that no member of a clearing bank should

be on the count. There would be a very definite conflict

of interest there which would be distinct and

inconvenient.

THE CHAIRMAN: Are there any further questions?

THE CHAIRMAN: I would

COMMISSIONER GIBSON: Lord Gopple, I would



1 like to ask you a little more about the part of the
2 executive directors. Do the executive directors and
3 the governor and the deputy governor, in fact, form a
4 sort of forum where the basic issues of monetary policy
5 are discussed, or where policy matters are discussed?
6 Do you throw out your ideas to them?

7 LORD COBBOLD: Certainly, yes, not quite in
8 the sense of direktorium of the old Reichsbank, if you
9 are conversant with that, which definitely had a corporate
10 responsibility as an executive direktorium, because, as
11 I was saying just now, we try as much as possible to
12 keep part-time directors and executive directors in
13 the same degree of corporate responsibility in the
14 business of the bank as a whole.

15 I think I can best answer your question by
16 giving you a practical picture. There is a meeting
17 every day with the four executive directors and one or two
18 of the top officials which is taken either by the governor
19 or the deputy governor. The governor always takes it
20 on Wednesdays and Thursdays which are committee of
21 treasury and court days. The economic adviser would
22 also appear on those days, and then we have a rather longer
23 and more general discussion. There is a morning meeting
24 every other day, which is taken by either the governor
25 or the deputy governor, with the four deputy directors
26 and possibly one or two officials just to run through
27 the business of the day.

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MORD GORBOUD: Certainly, yes, not quite in
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every other day, which is taken by either the governor
and possibly one or two officials just to run through
the business of the day.



1 COMMISSIONER GIBSON: You would be talking
2 about matters of direction of monetary policy?

3 LORD COBBOLD: Particularly on the two
4 more important days. By and large twice a week we
5 would be doing that; and, of course, very often the
6 governor would call perhaps two, perhaps three, perhaps
7 four executive directors, with the official particularly
8 concerned with that side of the business, together with
9 the economic advisors, if necessary, to discuss that
10 particular problem in the ordinary course of
11 administration. But you can take it that all the
12 executive directors are generally acquainted with
13 all aspects of what the bank is doing, and would be
14 included in the discussion of a particular aspect.
15 The governor would certainly not move without the
16 advice and full knowledge and without full discussion
17 with the executive director handling that particular
18 side of the business.

19 COMMISSIONER GIBSON: When you decide that
20 you would move a little this way or a little that
21 way in the direction of your policy, a little tighter
22 or a little easier, would it be accurate to say that
23 this would be a decision made by the governor, with
24 the advice of the appropriate people, or is it to any
25 extent a group decision, as in the case of the United
26 States?

27 LORD COBBOLD: I would say it is rather
28 more the decision of the governor.

29 COMMISSIONER GIBSON: It is more the decision
30 of the governor?



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this would be a decision made by the governor and
the advice of the executive directors would be sought
before a final decision is reached?

LORD COBURN: I would say it is rather
more the decision of the governor.
COMMISSIONER GIBSON: It is more the decision of



1 LORD COBBOLD: After consulting a great
2 number of people. I think it is easier to explain
3 this by taking a specific case. If one were
4 discussing a bank rate move, or a tightening or
5 easing up move, the general line of approach would
6 be that one would discuss it first, probably, with the
7 individual executive director handling that particular
8 side of the business, and one would probably discuss
9 it three or four times. I have known times when
10 we have had up to seven meetings in a single day.
11 The matter would be fully discussed with the executive
12 directors and one or two of the chief officials,
13 economic advisors and either contemporaneously or
14 just a little later the governor would probably be
15 discussing it with some or all the outside members
16 of the committee of treasury, to be sure they were
17 lined up in the same direction, or to see if they
18 had any comment.

19 COMMISSIONER GIBSON: This is very
20 interesting. If one of the executive directors
21 who was not necessarily very closely related to a
22 general policy decision, had a different view, would
23 he, in the normal course of events, come and tell you
24 that he had a different view?

25 LORD COBBOLD: Certainly. And how, if
26 I may say so.

27 COMMISSIONER GIBSON: So, in other words,
28 you would be banging the sort of major issues around
29 among yourselves quite a lot?

30 LORD COBBOLD: Yes, indeed. If I might

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I may say so.

COMMISSIONER GIBSON: So, in other words,

you would be bringing the sort of major issues around

very yourselves quite a lot?

LORD CORBOLD: Yes, indeed. If I might



1 say so, it is very often the executive directors and
2 part-time members of the committee of treasury who
3 are not concerned with a particular item who bring up
4 some objections which are very valid and need dis-
5 posing of before you can go ahead with it.

6 I have known a number of times when the
7 executive director responsible for staff and internal
8 administration had asked very pertinent questions from
9 the point of view, as he always puts it, of "the man
10 in the street".

11 COMMISSIONER GIBSON: There is one other
12 question I would like to ask. In the statement which
13 you made to us you observed that these decisions were
14 made by the court of directors knowing that they may
15 have to share responsibility for decisions, based
16 partly on the views which they individually expressed.
17 Is there any particular significance to saying that
18 the directors share responsibility for the decisions?

19 LORD COBBOLD: Well, I feel so, sir. It
20 has always been my view, in business generally, that
21 if you ask somebody whether he thinks something is
22 a good idea or not, as an outside individual he may
23 give you advice or he may say what he thinks that he
24 would like to hear. If he knows that he is going
25 to be responsible for the decision, his attitude in
26 the matter is going to be different, and he is apt
27 to be a little more precise and certainly more helpful.

28 COMMISSIONER GIBSON: I suppose that many
29 of the decisions that are formally taken by the court,
30 though, would be decisions in which some directors would

often the executive directors and part-time members of the committee of treasury who are not concerned with a particular item who bring up some objections which are very valid and need listening of before you can go ahead with it.

I have known a number of times when the executive director responsible for staff and internal administration had asked very pertinent questions from the point of view, as he always puts it, of "the man in the street".

COMMISSIONER GIBSON: There is one other question I would like to ask. In the statement which you made to me you observed that these decisions were made by the court of directors knowing that they may have to share responsibility for decisions, based partly on the views which they individually expressed. Is there any particular significance to saying that the directors share responsibility for the decision?

LORD CORRIE: Well, I feel so, sir. It has always been my view, in business generally, what if you ask somebody whether he thinks something is a good idea or not, as an outside individual he may give you advice or he may say what he thinks best he would like to hear. If he knows that he is going to be responsible for the decision, his attitude in the matter is going to be different, and he is apt to be a little more precise and certainly more helpful.

COMMISSIONER GIBSON: I suppose that many of the decisions that are formally taken by the court,



1 not have had much part?

2 LORD COBBOLD: In the case of any important
3 decision any member of the court would have an
4 opportunity of telling the governor that he did not
5 agree with it, before it was taken, and he would be
6 fully entitled to say in a very loud voice if he
7 did not agree with it, and he could expect to have
8 his reasons dealt with. I do not say a director
9 would resign. Obviously, if there is a big majority
10 in favour, as in the normal course in any business,
11 a lot of people are prepared to go along with the
12 majority, having expressed their individual view.
13 He would have a full opportunity of having his objections
14 considered.

15 COMMISSIONER GIBSON: In making your
16 statement you are emphasizing your view that directors
17 ought to speak up and make their own position quite
18 clear?

19 LORD COBBOLD: I think, to their colleagues,
20 but not afterwards. I should take a poor view if
21 somebody got up immediately after the decision is
22 taken and said they did not agree with it. But,
23 certainly, in the course of decision-forming directors
24 have the full right to make their views known.

25 I should regard it as part of the business
26 of the governor to know their views generally, not as to
27 whether bank rate should be $5\frac{1}{4}$ or $5\frac{1}{2}$ per cent, but the
28 governor would normally know currently, by seeing
29 all the part-time directors a couple of times a week,
30 probably, for a chat or talk, what their view was about



NEW YORK, N. Y., MAY 1, 1914

LORD CORBOLD: In the case of any important

question any member of the court would have an opportunity of telling the Governor that he did not agree with it, before it was taken, and he would be

very anxious to do so.

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1 whether there was too much economic activity or too
2 little. One would reckon to know their mind currently,
3 without necessarily consulting them on every particular
4 point. If I knew fourteen members of the court, say,
5 generally thought we ought to tighten up a bit and
6 two thought we ought to loosen up a bit, I should have
7 some very long conversations with the two before we
8 took it to the formal decision. Do I make myself
9 clear?

10 COMMISSIONER GIBSON: Yes, thank you very
11 much.

12 COMMISSIONER BROWN: Lord Cobbold, if it
13 is a decision like that, I gather you would consult,
14 first, the committee of the treasury, and that after
15 that you would probably have individual consultations
16 with most of the part-time directors before the court
17 met?

18 LORD COBBOLD: It is awfully difficult
19 to say; sometimes, yes. Normally, to avoid undue
20 embarrassment, one would not put specific problems
21 to other members of the court of directors before
22 the formal meeting. Again, if I may take a
23 specific instance, if we were considering raising the
24 bank rate from 5 to 5½ per cent, for example, I would
25 make it my business to ascertain in the week preceding that
26 that the body of opinion of the part-time directors was
27 that they thought there ought to be some tightening,
28 without necessarily consulting them on a specific
29 move at a specific time.

30 COMMISSIONER MACKINTOSH: You would feel it

whether there was too much economic activity or too much inactivity. I think that the Board should be without necessarily consulting them on every particular point. If I knew fourteen members of the board, say, generally thought we ought to tighten up a bit and two thought we ought to loosen up a bit, I should have some very long conversations with the two before we took it to the formal decision. Do I make myself

COMMISSIONER BROWN: Lord Gifford, is it as a decision like that, I rather you would consult first, the committee of the treasury, and that after that you would probably have individual conversations with most of the part-time directors before the board

LORD GIFFORD: It is awfully difficult to say; sometimes, yes. Normally, to avoid undue embarrassment, one would not put specific problems to other members of the board of directors before the formal meeting. Again, if I may take a specific instance, if we were considering raising the bank rate from 5 to 5½ per cent, for example, I would make it my business to ascertain in the week preceding that that the body of opinion of the part-time directors was that they thought there ought to be some tightening, without necessarily consulting them on a specific point at a specific time.

COMMISSIONER MACKINTOSH: You would feel



1 desirable to consult all of them, assuming the change
2 was pretty significant?

3 LORD COBBOLD: I would feel it desirable to
4 know their minds. In the majority of cases I would
5 know without consulting them, whether they felt the
6 move should be in that direction, and I should not have
7 to consult them specifically because one would talk
8 to them currently, probably once or twice a week.

9 In England we have this great advantage,
10 which I shall come onto, that of geographic concen-
11 tration. They are all in and out, and either the
12 governor would have talked to one of them, or the
13 deputy governor would have talked to another of them,
14 or one of the executive directors would have talked
15 to another of them. With such a geographic concen-
16 tration we are able to have a real corporate feeling
17 and, by and large, know what people are thinking.

18 COMMISSIONER BROWN: I wonder if I might
19 ask one supplementary question on the potential conflicts
20 of interest? In the committee of the treasury -- which
21 is the executive committee of the court, in effect --
22 is there any unwritten rule about the membership of
23 it?

24 LORD COBBOLD: No.

25 COMMISSIONER BROWN: Among the part-time
26 directors?

27 LORD COBBOLD: Except that there should not
28 be more than one executive director, and that the
29 majority should be non-executive.

30 COMMISSIONER BROWN: But they could all be



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LORD GOSBOLD: I would feel it desirable to

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UNOFFICIAL MEMBER: I wonder if I might

ask one supplementary question on the proposed constitution of interests? In the committee of the trustees - which is the executive committee of the court, in effect - is there any unwritten rule about the membership of

117

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LORD GOSBOLD: Except that there should not

be more than one executive director, and that the

majority should be non-executive.

COMMISSIONER BROWN: But they could all be



1 members of merchant banking institutions?

2 LORD COBBOLD: No, we should certainly
3 have some industrial and commercial representation
4 on the committee of the treasury. It is an
5 impossible situation in modern times that the
6 committee of treasury should be composed entirely
7 of executive directors and banking and financial
8 representatives. That would not happen, but there
9 would be one or two financial representatives there.

10 COMMISSIONER LEMAN: Lord Cobbold, as
11 you pointed out in your introduction, there are
12 certain features of a country like Canada that are
13 highly different from the type of organization existing
14 in England. One of them is the geography. This
15 group of people composing the court is a highly
16 concentrated group, geographically: they are all
17 available to the governors for consulting, on
18 practically a moment's notice. Do you feel that
19 is partly where their value lies, or in large part --
20 the fact that they are so readily available; and
21 that in a country like Canada, if they had to take
22 a week's trip to be available, it would not work?

23 LORD COBBOLD: I believe it complicates
24 the sort of organization I am talking about very much.

25 COMMISSIONER LEMAN: Has there ever been
26 any feeling in the U.K. that people who are not in
27 the City have views that are not sufficiently sound
28 and worthy of consideration?

29 LORD COBBOLD: We have, as a matter of
30 fact, tried to meet that to a certain extent. There

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1 is on the court, or there was in my time on the court,
2 one director whose business centre was Liverpool but
3 who was always up in London a couple of days a week.
4 There was one whose business centre was in Birmingham
5 who was always up in London a couple of days a week;
6 and there was one, a little earlier, whose business
7 centre was in Glasgow but who was up in London a
8 couple of days, or once a week or once a fortnight.
9 The geography is much easier, and people in those
10 sorts of positions do tend to be in London either once
11 a week or once in every two weeks, so you can, to
12 some extent, combine the advantages of having people
13 whose business centre is in a big provincial centre
14 but who normally come up to London very often.

15 COMMISSIONER LEMAN: These people, if they
16 visit London on their own business, would certainly
17 make it their duty to pay you a call?

18 LORD COBBOLD: They would certainly
19 drop in once a week, yes.

20 THE CHAIRMAN: We shall move to your
21 second point, the relations between the Bank of
22 England and Her Majesty's government. Perhaps
23 you would wish to make a statement on that first?

24 LORD COBBOLD: I would rather like to.

25 THE CHAIRMAN: Go ahead.

26 LORD COBBOLD: I think it might be
27 convenient to read into the record some of what I
28 put to you, if that is convenient.

29 THE CHAIRMAN: Go ahead, please.

30 LORD COBBOLD: I am sorry to harp on this

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THE CHAIRMAN: Go ahead, please.

LORD CORBOLD: I am sorry to harp on this



1 point, but I would like to repeat that I am thinking
2 about relations between the Bank of England and Her
3 Majesty's government in the United Kingdom, and not
4 about relations between central banks and governments
5 in general.

6 At the risk of being rather long, perhaps
7 I may recall what I said to the Radcliffe committee
8 on this subject, because this was a considered
9 statement at the time, and one which I think still
10 represents my opinion.

11 "I have no doubt that in modern
12 conditions it is proper that Government
13 should have the final word on policy and
14 that the central bank should not be free
15 to pursue a completely independent line.
16 At the same time, if the central bank is
17 to perform a useful function, it must be
18 a separate entity capable both of dealing
19 professionally in markets and of forming
20 its own views and giving independent
21 advice to Government. Contact between Bank
22 and Treasury must be close and continuous,
23 but Bank and Treasury should speak to each
24 other as separate institutions, forming
25 their opinions from different viewpoints and
26 different backgrounds. The Bank must be
27 in and out of the market, must enjoy the
28 confidence of Government on the one hand and
29 of the market on the other, and must be in
30 a position to interpret market opinions to



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1 "Government and Government opinions to the
2 market.

3 In a totalitarian state, with private
4 enterprise and markets more or less
5 eliminated, it would make sense for
6 central bank operations to be handled under
7 direct Treasury control, both as to policy
8 and as to detail. For any country
9 operating to a great extent with private
10 enterprise and markets, and working with
11 other countries similarly placed, I should
12 regard direct Treasury control over
13 central bank operations as a major weakness.
14 For a country as dependent as the U.K.
15 on international trade and confidence,
16 it could be a disaster.

17 The business of the central banker
18 is different from that of the Treasury
19 official. Apart from the physical im-
20 possibility of the same men handling such
21 different businesses, the necessary
22 attitude and approach are not the same.
23 The senior civil servant must always be
24 concerned with his Minister's responsibilities
25 in Government and in Parliament. The central
26 bank should not concern itself with political
27 or parliamentary questions. Its concern
28 should be with the general economic and
29 financial situation and with the day-to-
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1 "and abroad: only if it is in intimate and
2 continuous touch with markets and with
3 business opinion can it efficiently carry
4 out its twin functions of advising and
5 operating.

6 It would, in my view, be a mistake to
7 blur the identity and the separate
8 responsibilities of the two: with the two
9 institutions working so closely together," --

10 -- I mean, the Bank of England the treasury --

11 "-- there is always a tendency in that
12 direction unless it is resisted. A
13 policy of fusing the two by interchange
14 of staff or otherwise would gradually
15 but inevitably lead to a blurring of
16 responsibilities and functions; and,
17 as a matter of practical administration,
18 fusion and "cross-fertilization" would,
19 in my view, tend to prejudice rather than
20 improve relationships.

21 Arguments can doubtless be advanced
22 for variation, in either direction, in
23 the degree of formal independence of the
24 central bank from Government and in
25 allocation, either by statute or in practice,
26 of responsibilities between Bank and
27 Treasury. But the fundamental question
28 is whether the central bank should be a
29 separate entity, albeit the servant of the
30 Government of the day, or a sub-department

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1 "of the Treasury. I hold that, in present
2 and foreseeable economic conditions in the
3 Western world, the former is undoubtedly
4 right."

5 That was the statement which I made to
6 the Radcliffe committee on that subject. It so happens,
7 Mr. Chairman, that I was deputy governor before
8 nationalization, before the Bank Act of 1946, and
9 deputy governor and governor since then, so I had
10 unrivalled opportunities of seeing the degree of
11 change before and after. The Bank Act, in fact,
12 to some extent regularized the position which had
13 largely come about already by the developments to which I
14 have already referred. But it did, of course, give
15 statutory authority to the government's ultimate control,
16 which had not existed before. The Act was, however,
17 so drafted as to leave the court responsible for the
18 bank's affairs, subject to directions by the treasury,
19 to provide for consultation by the treasury with the
20 governor before the issue of any directions, leaving
21 the court with full power over internal matters, such
22 as recruiting, appointments, and salary scales.
23 In the outcome it has not yet proved necessary to invoke
24 the directions clause. In practice, the bank and
25 treasury maintain a very close contact at various
26 levels; and, again, in practice, it has always proved
27 possible to iron out differences of opinion and formulate
28 an agreed line of policy without the need of the formal
29 issuing of directions.
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1 I was asked a lot at the sittings of the
2 Radcliffe Committee and elsewhere where the initiative
3 comes from in a number of matters -- whether it
4 comes from government or bank. Of course, that is
5 always a very difficult question to answer when one
6 is in regular discussions with people, and when you
7 take a decision it is awfully difficult to say where
8 the idea originated two or three months earlier.

9 However, subject to that, by and large we
10 regard the responsibility for initiative in monetary
11 matters as lying with the bank. I would regard the
12 bank and its governor as more at fault if they
13 failed to take the initiative on a monetary problem
14 than the Chancellor and treasury officials who have
15 other things to do. This lies immediately in the
16 bank's field and the first initiative on monetary
17 matters lies with the bank. However, it would be a
18 matter of continuous discussion, and it is not always
19 easy to say where any particular suggestion or idea
20 originated.

21 I think that is all I would have to say,
22 sir, on that point.

23 COMMISSIONER HARROLD: Lord Cobbold, I
24 had one or two questions, but you have pretty well
25 covered what I had in mind, and on this question of
26 statutes, initiative and ultimate control, have you
27 found the government, on the question of tight money
28 or the raising of interest rates, has gone to the use
29 of the statute when there is a serious difference of
30 opinion with the bank officials?



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1 LORD COBBOLD: No, not down to the use of the
2 statute. I don't think we ever got to the stage of
3 pointing guns at each other. Obviously, there have been
4 occasions when there have been differences of views
5 which have had to be argued out at length, and there
6 have been occasions on which one party or the other has
7 accommodated itself and given way a bit here and there.
8 If two separate institutions are trying to work together,
9 that is an inevitable arrangement. However, broadly,
10 the answer to your question is no.

11 COMMISSIONER HARROLD: It is pretty clear from
12 what you have stated here that you think the present
13 arrangement whereby you have a separate institution,
14 and probably separate ways of appointing the staff,
15 coming from different backgrounds -- the bank people
16 and the treasury people -- you feel it is very desirable.
17 It is probably somewhat different in Canada, but in
18 comparing the two operations do you suggest it may be
19 more applicable to Canada?

20 LORD COBBOLD: I really could not offer an
21 opinion on that.

22 COMMISSIONER HARROLD: Under the conditions
23 in the U.K.?

24 LORD COBBOLD: Under the conditions in the
25 U.K. I have no doubt about that, and from this point
26 of view: That if the Bank of England were exactly
27 the same animal as the treasury in the sense it recruited
28 the same sort of people and thought from the same basis,
29 there is no point in having two animals. It is much
30 cheaper and more effective to have one animal. The

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1 only advantage you get is that you get primarily a market
2 approach from the central bank, with the governmental
3 considerations in mind, bearing on the official and
4 political approach, and in my experience the fusion of
5 these two and the bearing of one on the other has been
6 extremely useful. If you tried to change the bank into
7 a semi-government department you would lose that benefit,
8 and I think the maintenance of two separate institutions
9 would no longer have a bearing.

10 COMMISSIONER BROWN: Could I ask one question.
11 If in the circumstances that a difference of opinion
12 does develop, in marshalling your arguments do you con-
13 sult with the court about this difference of opinion and
14 does your strength vary?

15 LORD COBBOLD: Very flexible, sir. I again
16 say I should broadly know the mind of members of the
17 court. One would not normally, unless you came to an
18 absolute crisis, consult the court on a formal matter
19 late on Thursday morning. One would largely know the
20 mind of the court. Again, to put it in current terms,
21 if I thought I was running for a first-rate row with
22 the government of the day I should make sure I had
23 the court on my side before I got into that row.

24 COMMISSIONER LEMAN: Do you visualize the
25 possibility of the governor letting the situation get
26 to the point of having to receive a directive and staying
27 on?

28 LORD COBBOLD: I would not rule it
29 out.

30 COMMISSIONER LEMAN: It could be done? It

only advantage you get is that you get primarily a better
approach from the central bank, with the government
in mind, bearing on the official and
political approach, and in my experience the focus of
extremely useful. If you tried to change the bank into
a semi-government department you would lose that benefit
and I think the maintenance of two separate institutions
would no longer have a bearing.

COMMISSIONER BROWN: Could I ask one question
If in the circumstances that a difference of opinion
does develop, in marshalling your arguments do you con-
sult with the court about this difference of opinion and
does your strength vary?

LORD CORBOURN: Very flexible, sir. I should
say I should broadly know the mind of members of the
court. One would not normally, unless you came to an
absolute crisis, consult the court on a formal matter
late on Thursday morning. One would largely form the
mind of the court. Again, to put it in another way,
if I thought I was running for a third time now with
the government of the day I should make sure I had
the court on my side before I got into that row.

COMMISSIONER LEWIS: Do you visualize the
possibility of the governor letting the situation get
to the point of having to receive a directive and report



1 would not make his position impossible?

2 LORD COBBOLD: No. I could conceive of
3 circumstances in which one would say: "This is what the
4 Bank of England feels, but you gentlemen are ultimately
5 responsible for this, and if you want it done this way
6 for political or more general reasons than we know about,
7 you must take the responsibility for it and give me a
8 direction." That is by no means an inconceivable
9 position.

10 COMMISSIONER GIBSON: This would be made
11 public?

12 LORD COBBOLD: Yes.

13 COMMISSIONER GIBSON: At what point? After
14 the difference had emerged?

15 LORD COBBOLD: Oh, surely.

16 COMMISSIONER GIBSON: And the governor
17 required an initial directive?

18 LORD COBBOLD: There may be legal questions.
19 It has never arisen, and therefore has never been tested.
20 There may be Official Secrets Act questions or something.
21 However, in the position which Mr. Leman suggests I
22 think any governor would either feel he had to resign
23 or require it be made public he was acting under
24 direction.

25 COMMISSIONER GIBSON: This would be after he
26 received the directive?

27 LORD COBBOLD: Oh, certainly.

28 COMMISSIONER BROWN: Would it be after the
29 new policy had been put into effect?

30 LORD COBBOLD: I would think certainly. One



LORD CORBOLD: No. I could conceive of

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COMMISSIONER BROWN: Would it be after the

new policy had been put into effect?

LORD CORBOLD: I would think certainly. The



1 cannot cover all circumstances, but as I envisage that
2 happening it would certainly be afterwards.

3 COMMISSIONER GIBSON: Do you think the
4 existence of the power to direct means it is very unlikely
5 the power will be used or be necessary?

6 LORD COBBOLD: As I think I have indicated
7 in my statement, I personally welcome the power to
8 direct. I think it regularizes the position which I
9 believe is the de facto position of the relationship
10 between the government and the bank, and I think it is
11 more convenient and appropriate to have some power of
12 that sort so that you know where you are, and in the
13 sort of circumstances to which Mr. Leman was referring
14 you can put to the public exactly what has happened.

15 COMMISSIONER GIBSON: Do you think the treasury
16 will make just as much of an effort as formerly to
17 adjust their views?

18 LORD COBBOLD: That has been the experience,
19 that in the normal give and take between bank and treasury
20 I have not been conscious of any difference before or
21 after. As I think my predecessors made clear, and as
22 I have made clear several times, the view of the bank
23 has been, long before the Bank Act, that in the last
24 resort after a great deal of advice -- Lord Norman
25 used the words "after a lot of nagging" -- the bank
26 recognized it had to follow the policy. It does slightly
27 alter the public status, or could if directions were
28 used frequently. I don't think in fact it has altered
29 the status, and I believe it to be, so far as the Bank
30 of England is concerned, a convenient and proper arrange-

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the status, and I believe it to be so far as the bank

is concerned a convenient and proper arrangement.



1 ment.

2 COMMISSIONER LEMAN: We talk about these
3 directives rather freely, and this may be a little unfair
4 because it has never been used in England, but if you
5 try to visualize a little more precisely what such
6 a directive would consist of, it would have to be quite
7 precise because the bank would still have to execute
8 the directive?

9 LORD COBBOLD: Certainly.

10 COMMISSIONER LEMAN: If it had to execute
11 something which it inherently felt was quite wrong, and
12 must have felt was wrong because plenty of discussion
13 had taken place, the directive would have to be couched
14 in very precise terms, wouldn't it?

15 LORD COBBOLD: I believe so.

16 COMMISSIONER LEMAN: Right down to figures,
17 etc.?

18 LORD COBBOLD: I would judge so. Really, a
19 direction in those circumstances must come to the treasury
20 taking over the helm.

21 COMMISSIONER MACKINTOSH: Would it be fair
22 to say aside from recognizing the position of the govern-
23 ment that there is need for a less catastrophic way of
24 impasse than the resignation of the governor?

25 LORD COBBOLD: I believe that is true, yes.

26 COMMISSIONER MACKINTOSH: That is a way out,
27 and if the occasion, so to speak, is great enough ...?

28 LORD COBBOLD: Obviously, there must be
29 occasions when the governor thinks it proper to resign,
30 but, as I said previously, I can envisage circumstances



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1 when the governor could within his conscience think
2 his proper duty is to accept a direction on a particular
3 matter and say, "That is their responsibility and not
4 mine." I think if that happened very frequently the
5 governor would be in a very difficult position and
6 probably could not stand up to it; but in isolated
7 instances I have always felt it is a possibility which
8 one could envisage.

9 COMMISSIONER GIBSON: How far do you think
10 the general public -- an informed public -- should be
11 kept informed about the Bank of England's general views
12 on monetary policy? I take it from what you say there
13 is a good deal of understanding between the bank and
14 the financial community through directions and informal
15 contacts and so on. Do you believe an active effort
16 should also be made by the bank to inform the general
17 public?

18 LORD COBBOLD: This is a very difficult
19 question indeed, Mr. Gibson. My first answer to the
20 question would be yes; I do believe within limits it
21 is very important, and over the past ten years the
22 Bank of England has been making progressive efforts to
23 try and disseminate views around the country and I, myself,
24 made a number of speeches here and there while in office.
25 We have, of course, a very strong tradition of absolute
26 secrecy lasting over the centuries, and that has to be
27 broken down a little gradually, but we have certainly
28 tried to break it down, and I think it is right to break
29 it down. On the whole we have tended to take the line
30 that if one is in disagreement with the government of



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 effort to break it down, and I think it is right to



1 the day it is probably better to have that disagreement
2 rather quietly until it is at least near solution or
3 has arrived at solution than to express the bank's
4 views very largely during the course of argument.
5 However, I would not at all say that is always the right
6 view, and again I can perfectly well conceive of
7 circumstances when it would be proper for the bank to
8 let it be known they were not in entire agreement with
9 certain aspects of policy. I think you can only judge
10 on particular occasions and in particular circumstances.

11 COMMISSIONER GIBSON: Let me put it another
12 way: You see, if you wait until there is an acute
13 disagreement I can see the problem you mention -- the
14 bank making loud statements would create difficulties --
15 but is there much discussion of monetary policy outside
16 this small group in the city in the I.K.?

17 LORD COBBOLD: There has always seemed to be
18 at certain times an enormous amount of discussion in
19 many circles, most of which is saying how secretive the
20 Bank of England is and how much better it would be if
21 it would talk a bit more. We have tried to meet that
22 to a certain extent, but our feeling has been that it is
23 something which one needs to go a little gradually with.

24 COMMISSIONER GIBSON: You have some very
25 good financial journals?

26 LORD COBBOLD: First rate, and they are in
27 and out of the building all the time and talking to our
28 economic advisers, and so on. There is a very good
29 contact between the bank and the financial press.

30 COMMISSIONER GIBSON: You feel amongst the



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way: You see, if you wait until there is an actual
disagreement I can see the problem you mention -- the
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but as there much discussion of monetary policy outside
this small group in the city in the U.K.?

LORD CORBOLD: There has always seemed to be
at certain times an enormous amount of discussion in
many circles, most of which is saying how serious the
Bank of England is and how much better it would be if
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COMMISSIONER GIBSON: You feel amongst the



1 public that are interested there is a fairly continuous
2 discussion and interest in monetary matters?

3 LORD COBBOLD: Pretty wide and increasing
4 all the time.

5 COMMISSIONER HARROLD: These speeches you
6 mentioned: Has that been the practice of former governors
7 as well?

8 LORD COBBOLD: No, I rather did a good deal
9 more of that than my predecessors did.

10 COMMISSIONER HARROLD: This was with the
11 concurrence of the court?

12 LORD COBBOLD: Concurrence and encouragement.
13 Of course, the court help in that a great deal because
14 they are moving about at high level in very varied
15 circles, and people talk to them over lunch and at social
16 gatherings, and so on, and they are able to do a good
17 deal of helping with the general discussions of the sort
18 of things which are occupying the bank's thoughts at the
19 time.

20 THE CHAIRMAN: You may have covered this
21 point and I haven't recollected it: What is the term of
22 office of the governor -- or, is there a definite term?

23 LORD COBBOLD: Five years for governor and
24 deputy governor; four years for directors, renewable.

25 ---SHORT RECESS
26
27
28
29
30



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THE CHAIRMAN: You may have covered that.

point and I haven't recalled it: What is the last

office of the government -- or, is there a definite



1 THE CHAIRMAN: We will now resume. Mr.
2 Brown has some additional questions which he would
3 like to ask.

4 COMMISSIONER BROWN: Mr. Chairman, I
5 would like to go back just a little bit to the first
6 discussions you were having and ask a supplementary
7 question on the executive directors of the bank.
8 Lord Cobbold mentioned that this gave them increased
9 stature outside the bank and in the court, and I
10 wonder if he would mind telling us whether this
11 made a difference in their relationships with him
12 personally?

13 LORD COBBOLD: You mean is the degree of
14 importance one would attach to what he is saying in
15 discussions?

16 COMMISSIONER BROWN: And their freedom
17 to give you advice on their own rather than looking
18 just to yourself.

19 LORD COBBOLD: Yes, I would think it does;
20 certainly it is an additional status, and he, after
21 all, becomes a colleague as a member of the board
22 of directors and court of directors, and perhaps feels
23 more free to press his views, than an official,
24 however senior. I think I did mention that
25 it also enables him to speak on equal terms with
26 part-time directors of the court, which is another
27 very important aspect of it. But, I think if the
28 governor and deputy governor found themselves hotly op-
29 posed by executive directors on a particular issue, they
30 would certainly think very carefully before they took that
any further;



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by executive directors on a particular issue, they

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1 they would certainly attach -- perhaps just that little
2 more weight and status to anybody who is a member
3 of the court.

4 COMMISSIONER BROWN: Thank you very much.
5 The other question I would like to ask, and this is
6 on the question of the directors, the part-time
7 directors, you mentioned that you had representatives
8 from banks, finance, shipping and the trade unions.
9 I assume that this has been found to be very useful
10 and practical?

11 LORD COEBOLD: Yes indeed. I think that
12 all the people we have had from the trade unions --
13 I would like again to say that they are not representa-
14 tives in the sense that they are appointed by any
15 particular party; it is Mr. X who happens to be a
16 prominent person in the trade union field. He is
17 not, so to speak, there representing the T.U.C. in
18 the formal sense. They have been extremely helpful
19 in the last four or five years under my governorship.
20 We had one of the people who came from that circle
21 on the committee of treasury and he was a most
22 valuable member of the team.

23 COMMISSIONER BROWN: Thank you very much.

24 COMMISSIONER GIBSON: One supplementary
25 question, sir; you stated in your initial statement
26 that the part-time directors -- indeed, all the
27 directors -- were appointed on the advice of the
28 government of the day, on the government's suggestion.

29 LORD COEBOLD: Formally appointed by
30 the Queen in a constitutional form, which means on the



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1 advice of the Prime Minister.

2 COMMISSIONER GIBSON: I was wondering how
3 the suggestion came up as to who would be appointed?

4 LORD COBBOLD: The Prime Minister and
5 the Chancellor of the day have been good enough to
6 consult the governor on every occasion on appointment
7 or re-appointment.

8 THE CHAIRMAN: Then we come to point three;
9 relations between the Bank of England and banks and
10 other financial institutions of the United Kingdom.
11 Would you like to restate --

12 LORD COBBOLD: Perhaps I might make a
13 few introductory remarks on that. There again I
14 would stress very much the geographical advantage
15 that we have in London over many other financial
16 centres. There is, as you are aware, a very high
17 degree of centralization of boards of directors and
18 general management of the leading financial institutions
19 in London and, in fact, in the city of London, and it
20 really is no exaggeration to say if the Governor of
21 the Bank of England wishes to consult with the leading
22 representatives of the financial community in the
23 United Kingdom -- banking, insurance, investment
24 trust, stock exchange and a good deal of commercial
25 as well -- he can in fact get them all in his room
26 in half an hour and that, of course, does make a
27 very great difference and I very often, in speaking
28 particularly in the United States, pointed out the
29 difference of Mr. Martin's problem and my own problem
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advantage of Mr. Martin's position and my own position.



1 If he endeavoured to get a joint opinion
2 from the United States banking community, he probably
3 would have to have 10,000 people there and many of
4 them probably would have to travel several thousand
5 miles, and it is a very different proposition, and
6 I think it is extremely important to bear that in
7 mind in considering how the London arrangements
8 might affect, or be translated into terms of arrange-
9 ments particularly on this continent.

10 It is extremely important in being able
11 to get people into one's room; the heads of all the
12 banks, the heads of most of the insurance companies,
13 and the stock exchange, and so on, but in many ways,
14 I would judge it even more important because it means
15 that, if you like, socially, or in meeting on the
16 street, or in travelling up and down, or luncheon in
17 the city or in the evenings, the central bank people
18 are always meeting the leaders in the commercial
19 banks and the leading insurance and finance companies.
20 not only at top levels, but further down as well, so
21 that there is a natural and easy exchange of ideas
22 and thought.

23 We have always encouraged our senior
24 people, for example, to lunch around the city with
25 the large banks and insurance companies so that they
26 get to know their opposite members, and although I
27 don't say they discuss detailed issues on these sort
28 of occasions, it does mean there is a continual inter-
29 change and the people in the commercial banks always
30 know pretty intimately the people who are running the



1 foreign exchanges or the internal market, and I think
2 they feel that way, that they are not so far apart
3 and that there is less of an ivory tower than they
4 would feel if that easy contact were not available.

5 I stress this because I think this is
6 very important in the way that our institutions have
7 grown up, and again I very fully recognize that that
8 is far more difficult in a country like this, of this
9 size, with your provincial divisions and so on. But
10 as far as the London organization is concerned, it
11 certainly is extremely important.

12 Passing in rather more detail to relation-
13 ships with the various parts of the market, by far
14 the most important, of course, is the relationship
15 between the Bank of England and the clearing banks.
16 There are, as you know, eleven clearing banks -- what
17 we call the "Big Five" -- and then six others; they
18 control the bulk of the deposit banking business
19 together with the Scottish and Northern Irish banks,
20 which I will refer to in a minute. By far our
21 most important contact is with the clearing bank
22 system. I think this is so important that it would
23 be worthwhile just repeating what I said to the
24 Radcliffe committee on that subject, if I may.

25 So far as the clearing banks are concerned,
26 there is a regular quarterly meeting between the
27 governors and the chairmen of the clearing banks,
28 with the governor or deputy governor in the chair.
29 The Committee of London Clearing Bankers meet every
30 month by themselves, and under these arrangements once



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1 a quarter they meet at the Bank of England. From
2 time to time, if there is anything of sufficient
3 importance to warrant it, the governor attends one
4 of the other monthly meetings, or on occasion there
5 is a special ad hoc meeting at the Bank of England
6 with the members of the Committee of London Clearing
7 Bankers, which represent the eleven clearing banks,
8 but the main contact is between the governor and
9 the deputy governor on the one hand and the chairman
10 and the deputy chairman of the Clearing Bankers
11 Committee on the other. I could not say exactly
12 how often we meet, but I should think once or twice
13 a week on the average, less when there is nothing
14 of particular interest to discuss, and, of course,
15 very much more when there is any particular issue.
16 But whether or not there are particular issues, the
17 governor has always made a point of regular meetings
18 with the chairman of the Clearing Banks Committee
19 to keep a close contact and make sure if anything is
20 arising that it is discussed between them.

21 On the whole, both parties have found it
22 more convenient to deal with it in this way, through
23 the chairman of the Clearing Banks Committee and
24 the governor and deputy governor, rather than to
25 have the full meeting of the Committee on each occasion.
26 That is the contact at top level.

27 Then there is regular contact between the
28 Chief Cashier, who is the senior operating official
29 of the bank, and the chairman and the deputy chairman
30 and the Chief Executive Officers' Committee, which is



...er they meet at the Bank of England. From
time to time, if there is anything of sufficient
importance to warrant it, the Governor attends one
of the other monthly meetings, or on occasion there
is a special ad hoc meeting at the Bank of England
with the members of the Committee. It is a
Bankers, which represent the eleven clearing banks,
but the main contact is between the Governor and
the deputy Governor on the one hand and the chairman
and the deputy chairman of the Clearing Bankers
Committee on the other. I could not say exactly
how often we meet, but I should think once or twice
a week on the average, less when there is nothing
of particular interest to discuss, and, of course,
very much more when there is any particular issue.
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1 the operating committee for the Committee of London
2 Clearing Bankers.

3 There are also, of course, a lot of contacts
4 with individual clearing banks on matters which affect
5 the individual bank rather than the banking community
6 as a whole. Very often one of the chairmen or one
7 of the chief officers comes in to see the governor or
8 the chief cashier either on matters affecting that
9 particular bank and sometimes on matters of more
10 general interest. On top of that there is the day-
11 to-day routine contact in the money market between our
12 discount office and the clearing banks' money departments,
13 and on the Overseas side between our exchange offices
14 and the clearing banks' Overseas offices. I think
15 there is a continual link and contact on market
16 matters going on all the time as well as a link
17 on policy or more general matters. That, as I say,
18 is the most important contact in the city.

19 We also have a very close contact with the
20 accepting houses, with the Accepting Houses Committee
21 and with the individual houses and, as has already been
22 referred to, there are several directors of the bank
23 who came from the accepting houses.

24 Then, we keep in touch, too, with the
25 Scottish and Northern Irish banks; we always are at
26 pains to keep them informed and in discussion on
27 any general change of policy. There is a Scottish
28 and Northern Irish Banks Committee and we deal direct
29 with them, although in many cases there are direct
30 links between the Scottish and Northern Irish banks and



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and Northern Irish Bank's Committee and we deal directly

with them, although in many cases there are direct

links between the Scottish and Northern Irish banks and



1 the London clearing banks.

2 Apart from the banking system, we have a
3 close relationship with various other sections of the
4 financial market. Take the Stock Exchange Committee,
5 for example; the governor would arrange to see the
6 chairman of the Stock Exchange probably once in a week
7 or once in two weeks, or more frequently if there
8 were any particular matter under discussion; with
9 the insurance companies who have representative
10 committees, the issuing houses, the trust companies,
11 and the investment companies. The last named
12 perhaps a little less frequently than with the banks,
13 accepting houses, stock exchange and the insurance
14 companies.

15 The relationships with the banking system
16 and control of credit generally have -- as I think
17 the Commission will be aware -- been exercised in
18 England since the war by what I have called a conscious
19 mixture of informal requests and persuasion, together
20 with monetary weapons such as bank rate, open market
21 operations and, more latterly, special deposits and largely
22 for the reasons which I gave in my initial opening statement
23 that there has always been a tradition of close
24 co-operation and I think the preference of the
25 London banking system to work on the basis of un-
26 written law and on the basis of having a word with
27 The Bank of England rather than waiting to have official
28 and formal directions and that tradition has, to a
29 very large extent, continued and it is the normal
30 and accepted practice that the governor in nine cases



close relationship with various other sections of the financial market. Take the Stock Exchange Committee. The committee has a representative of the chairman of the Stock Exchange probably once in a month or once in two weeks, or more frequently if there were any particular matter under discussion; with the insurance companies who have representatives committees, the issuing houses, the trust companies, and the investment companies. The last named perhaps a little less frequently than with the banks, accepting houses, stock exchange and the insurance companies.

The relationship with the banks and control of credit generally have -- as I believe the Commission will be aware -- been somewhat in England since the war by what I have called a somewhat mixture of informal vagueness and persistence, together with monetary organs such as bank rates, open market operations and, more latterly, special deposits and so forth. For the reasons which I gave in my initial opening statement that there has always been a tradition of close co-operation and I think the preponderance of the London banking system to work on the basis of unwritten law and on the basis of having a word with The Bank of England rather than waiting to have official and formal directions and that tradition has, to a very large extent, continued and it is the same.



1 out of ten after discussion with the Chancellor of
2 the Exchequer and the Treasury should indicate the
3 Bank's wishes, which are often the combined wishes
4 of the bank and government and that they could
5 indicate them privately through the chairman of the
6 Clearing Bank Committee and the other committees,
7 rather than issue any sort of formal directive, and
8 it has always been accepted that views conveyed in
9 that rather informal way have much the same force
10 as a more formal direction.

11 We have found that useful because it
12 enables us -- before always saying what we want, we
13 have the opportunity of informal discussion with
14 representatives of the banks, and they have often
15 put it to us that it would be easier for them to do
16 it in a slightly different way and reach the same
17 result, and we have been able to make an adjustment
18 here and there which would be not possible if these
19 requests were conveyed in a more formal method.



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1 The greatest difficulty, I think, that we
2 have run up against in the past few years -- to some
3 extent right from the end of the war, but it is growing
4 all the time -- is this question of what are usually
5 called near banks; that is to say, those institutions
6 that do not come within any of the categories of
7 clearing banks, accepting houses, or issuing houses,
8 but which take deposits and lend money in one way
9 or another in direct or indirect competition with
10 the clearing banks. This has become an extremely
11 difficult subject, and, frankly, I am bound to say
12 that we have not reached any sort of a solution to
13 this difficulty in the United Kingdom. I think
14 the same difficulty exists in many other markets
15 around the world, and it is a problem which, certainly
16 in my time, has engaged a great deal of thought and
17 time of central bank governors, and I would guess it
18 is still doing so. My own feeling is that there
19 will probably have to be some new legislation or,
20 at any rate, some new arrangements in the United
21 Kingdom in order to try to cover this very intractable
22 subject.

23 Obviously, the clearing banks and the
24 accepting houses, and those that are covered by these
25 requests or special deposit arrangements, increasingly
26 find it irritating that they have to conform with
27 requests or directions which frequently mean losing
28 business, and there is a tendency for that business
29 to be taken over by people who are outside those
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Obviously, the clearing banks and the accepting houses, and those that are covered by these requests or special deposit arrangements, increasingly find it irritating that they have to contend with requests or directions which frequently mean losing business, and there is a tendency for that business to be taken over by people who are outside those categories and who are not subject to either formal



1 or informal discipline by the central authority.
2 PEOPLE: I would not like to go so far as to say
3 the relationships were strained at all, but I think
4 it would be fair to say that the banking community
5 that is, the clearing banks, the accepting houses,
6 and the other members of the regular categories --
7 is finding it increasingly difficult and unfair
8 that they should be asked from time to time to
9 conform to reduce lending and to have the special
10 deposit arrangements applied to some of them, and
11 at the same time to see a good deal of business
12 which they might otherwise have done pass into
13 other channels.

14 So far as the United Kingdom is concerned,
15 I can only say that that is something that is being
16 studied very actively. I think my successor and
17 his colleagues are extremely conscious of the
18 difficulties that this situation presents, and
19 that we are by no means at the end of that story.
20 I think that is about all I have to say.

21 COMMISSIONER HARROLD: Lord Cobbold,
22 you are conscious of the geographic situation as
23 between the Canadian central bank and the United
24 Kingdom central bank. If you were faced with a
25 somewhat similar situation in the United Kingdom,
26 would you feel that a strong branch system would
27 overcome some of the difficulties?

28 LORD COBBOLD: I do not think it would
29 nearly meet the same thing that I am talking about.
30 I think it would help in some degree. Of course, the



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I would not like to go so far as to say the relationships were severed at all, but I think it would be fair to say that the banking community, that is, the clearing banks, the accepting houses, and the other members of the regular categories -- is finding it increasingly difficult and unfair that they should be asked from time to time to conform to reduce lending and to have the special deposit arrangements applied to some of them, and at the same time to see a good deal of business which they might otherwise have done pass into other channels.

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THE CHAIRMAN: Now, would you are conscious of the geographic situation as between the Canadian central bank and the United Kingdom central bank. If you were faced with a somewhat similar situation in the United Kingdom, would you feel that a strong branch system would overcome some of the difficulties?

MORD COBBOLD: I do not think it would nearly meet the same thing that I am talking about. I think it would help in some degree. Of course, the



1 advantage we have is that we can meet with the top
2 people and the responsible people easily and regularly.

3 COMMISSIONER HARROLD: As an operator
4 of a central bank you would see some difficulty in
5 the branch system trying to take on this sort of
6 an operation?

7 LORD COBBOLD: I would only say so if
8 it is the top people who can get together all the time.
9 If you have the top people going around, so to
10 speak, and basing themselves on branches, it could
11 be helpful.

12 I do not know whether this is a helpful
13 comment, but we do that in the United Kingdom in a
14 very minor degree. We have small branches in most
15 of the big provincial cities in England, and it
16 has always been our practice for an executive director
17 to go around pretty regularly and sit in the branch
18 for a couple of days or so, and make sure of meeting
19 the business community and the financial community
20 in that district. While I was the governor I made
21 it a point of going around myself once a year, perhaps,
22 to most of those centres, and having lunch or dinner
23 and a talk afterwards with the leaders in those
24 places.

25 COMMISSIONER HARROLD: You also mentioned
26 the Scottish and Northern Ireland banks and committees.
27 Would these committees be located in London?

28 LORD COBBOLD: No, in Edinburgh and
29 Belfast.

30 COMMISSIONER HARROLD: And you were able to



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LORD GOBOLD: I would only say so if it is the top people who can get together all the time. If you have the top people going around, so to speak, and dealing themselves on branches, it could be helpful.

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the Scottish and Northern Ireland banks and committees. Would these committees be located in London?

COMMISSIONER HARROLD: And you were able to



1 get some kind of a contact that was satisfactory?

2 LORD COBBOLD: Yes. They come down, of
3 course, to London pretty often because the chairmanship
4 rotates between the leading Scottish banks, and the
5 chairman of the Scottish banks committee tends to
6 be in London at least once a month, and perhaps more
7 often. Very often he would drop into the bank, and if
8 the Bank of England had anything important we
9 would send up a director or a senior official to
10 Edinburgh to discuss things with them in the same
11 way as we would discuss things with the Committee
12 of London Clearing Bankers. But, as I say, the
13 majority of the Scottish banks have very close
14 contacts with, or are owned or partly owned by, the
15 London banks. In one case it is the Scottish bank
16 that owns, or mainly owns, the London Clearing Bank.

17 COMMISSIONER HARROLD: I have heard it
18 said at one time or another that one of Scotland's
19 main exports to London is bank managers.

20 LORD COBBOLD: I should think it is about
21 equal to their export of bank managers to other
22 parts of the Commonwealth.

23 COMMISSIONER GIBSON: May I ask you a
24 question about the meetings between the clearing
25 bankers and the Bank of England. Are these meetings
26 fairly informal in their character?

27 LORD COBBOLD: I would say that on the
28 whole the quarterly meetings between the governors
29 and the chairmen tend to be rather formal, although
30 on occasions I have known a subject to be discussed

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1 pretty informally. However, the quarterly meetings
2 are mainly formal.

3 If there is a subject which requires more
4 informal discussion, it would be discussed between
5 the governor and the chairman personally who, as
6 I said, have frequent informal discussions ranging
7 over a wide field with either party free to bring
8 up anything he wanted to bring up. On a number of
9 occasions I have know of ad hoc meetings of the
10 committee to discuss a particular subject of urgent
11 interest, and then they would tend to be rather less
12 formal.

13 The governor would also normally take
14 the opportunity of the quarterly meetings to talk
15 for ten minutes or a quarter of an hour when he
16 would give a general picture of his view of the
17 situation at the time.

18 COMMISSIONER GIBSON: That leads to my
19 next question. Are the subjects of discussion
20 usually technical matters concerning the use of the
21 Bank of England, about the market or banking arrange-
22 ments, or do you range over the broad field of
23 economic policy?

24 LORD COBBOLD: As I was saying, I would
25 always take the opportunity of a quarterly meeting
26 to range a little widely over everything that I
27 thought ought to be in the minds of the chairmen
28 of the clearing banks.

29 COMMISSIONER GIBSON: You would talk about
30 the trend of business and exchange problems?



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COMMISSIONER GIBSON: You would talk about
the trend of business and exchange problems?



1 LORD COBBOLD: Yes. I would even, for
2 example, say that in our opinion employment is falling
3 down a little, or that it looks a little upish, and
4 I would go around the table to see whether anybody had
5 a different opinion or whether those opinions on a
6 rather general matter were confirmed. If we were
7 discussing some particular transaction or section of
8 the market, then that would tend to be done between the
9 chief cashier and the chief executive officers.

10 COMMISSIONER GIBSON: So the meetings do
11 discuss the general financial atmosphere to quite a
12 large extent?

13 LORD COBBOLD: Yes. I would not say that
14 those meetings would discuss policy as such, or what
15 we were going to do about anything. That would not
16 be normal. Those meetings more normally would discuss
17 some particular thing that was bothering the banks
18 and that they would raise with the governor. For
19 example, this question of near banks has often been
20 raised at those meetings.

21 The main discussion of economic problems
22 would, as I say, result from the short survey which the
23 governor would normally give, and he would then largely
24 be taking the opportunity of seeing whether anybody
25 had any comment on this general view of the situation,
26 or the Bank's general view of the situation, or whether
27 the banks were by and large in agreement.

28 We also have an arrangement by which from
29 time to time, when we see a change in the economy in
30 one direction or another, I would ask



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1 the chairman of the Clearing Banks Committee to arrange
2 for all the clearing banks to collect from their
3 branches and process at their head offices a general
4 survey of the situation and send it into us as of
5 June 30, or whatever date it might be. This is
6 not a regular arrangement because we have always
7 felt that regular returns tend to lose a little bit
8 and become routine things, but we have very often
9 found, when there was a change in the situation,
10 that it was useful to gather a general report from
11 all the clearing banks, and the Scottish banks as
12 well, and get that processed by the Committee of
13 London Clearing Banks and sent in to us. That
14 would, of course, be supported by the very frequent
15 discussions between the governor and the chairman
16 of the clearing banks committee.

17 COMMISSIONER GIBSON: You might telephone
18 him any day or he might drop in to see you at any
19 time?

20 LORD COBBOLD: Yes, we very frequently
21 do that.

22 COMMISSIONER GIBSON: And you might talk
23 about another subject? Your talks would not be held
24 to any narrow field?

25 LORD COBBOLD: We might talk about any
26 subject. Very frequently he would telephone me and
27 say: "If you have five minutes I would like to look
28 in". In times that were difficult, I think that that
29 might happen two or three times a week, and the chairmen
30 of the other clearing banks might do it as well if they



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1 had anything on which they particularly wanted the
2 Bank of England's action. If they had something
3 which they thought we ought to know about they would
4 come over and have a chat.

5 COMMISSIONER GIBSON: Do you feel they
6 were very forthcoming in expressing their opinions
7 to you?

8 LORD COBBOLD: Very.

9 COMMISSIONER GIBSON: They were not at
10 all reserved?

11 LORD COBBOLD: No, I found very little
12 reserve on the subject.

13 COMMISSIONER BROWN: Are there channels
14 between yourself and the chairmen of the foreign
15 banks in London -- that is, the Commonwealth and
16 foreign banks?

17 LORD COBBOLD: On any major move we would
18 see the chairmen of a number of committees. There
19 is the chairman of the committee of American banks,
20 and a number of committees of overseas banks -- I
21 think there are four in all. When we are issuing
22 any regulation or directive we would see the chairmen
23 of those committees as well as the British banks.

24 COMMISSIONER BROWN: Do you find the
25 same degree of co-operation on the moral suasion issues?

26 LORD COBBOLD: Yes, they have behaved
27 extraordinarily well.

28 COMMISSIONER BROWN: Do you have any
29 contact or discussions with the issuing houses or
30 the stock exchanges when a new government issue is

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COMMISSIONER BROWN: Do you have any

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1 under discussion?

2 LORD COBBOLD: I would hardly say there is
3 discussion with the stock exchange. We work, of
4 course, through the government broker so far as the
5 stock exchange is concerned, and our officials
6 would have a great number of discussions with the
7 government broker, and we would look to him to
8 reflect stock exchange opinion and to advise us
9 on stock exchange conditions and stock exchange
10 terms. Then, again, the stock exchange is just
11 over the road, and many of our senior officials
12 would be pretty well informed about what a lot of
13 people over the road were thinking at any particular
14 time. There is a geographic question which
15 comes in again there.

16 COMMISSIONER BROWN: Does he inform
17 you of the feeling on the floor of the exchange?

18 LORD COBBOLD: To some extent, but
19 when we are dealing with the government broker
20 he advises us as precisely as any head broker
21 would advise any bank. Of course, the fixing
22 of terms of a new government issue is a matter for
23 government, but it is very largely guided by the
24 Bank of England's advice. We handle all the
25 practical and operating side of those transactions.
26 The procedure would be that there would be many
27 initial discussions between the chief cashier
28 and our operating officials and the government
29 broker's people, who would work the thing up to a
30 certain pitch. It would then come up to the



LORD CORBOLD: I would hardly say there is

discussion with the stock exchange. We work, of course, through the Government broker so far as the stock exchange is concerned, and our officials would have a great number of discussions with the Government broker, and we would look to him to reflect stock exchange opinion and to advise us on stock exchange conditions and stock exchange terms. Then, again, the stock exchange is just over the road, and many of our senior officials would be pretty well informed about what a lot of people over the road were thinking at any particular time. There is a geographic question which comes in again there.

COMMISSIONER BROWN: Does he inform

you of the feeling on the floor of the exchange?

LORD CORBOLD: To some extent, but

when we are dealing with the Government broker he advises us as precisely as any head broker would advise any bank. Of course, the fixing of terms of a new Government issue is a matter for Government, but it is very largely guided by the Bank of England's advice. We handle all the practical and operating side of those transactions. The procedure would be that there would be many initial discussions between the chief cashier and the Government broker, who would work the thing up to a certain pitch. It would then come up to the



1 governor's level and when a decision was near being
2 reached the governor would have a talk, or perhaps
3 two or three talks, with the government broker before
4 making a recommendation to government.

5 COMMISSIONER MACKINTOSH: May I ask a
6 question here? You spoke of the concern that the
7 Bank of England felt in respect of the near banks?

8 LORD COBBOLD: Yes.

9 COMMISSIONER MACKINTOSH: Is the hesitation
10 here a matter of being unwilling to take the step of
11 bringing these groups within the banking system, or
12 is it occasioned by the technical difficulties that --

13 LORD COBBOLD: I am afraid I am a bit
14 behind-hand on this because this matter may have
15 moved since I had anything to do with it. When
16 I had to do with it it was solely on the technical
17 and legal side of drafting where enormous difficulties
18 seemed to present themselves. There was difficulty
19 about the definition of a bank and as to how you would
20 bring them in. It was a difficulty in drafting any
21 statutory clauses which would affect the different
22 types of near banks. They were all technical
23 legal and drafting difficulties. I think everybody
24 recognizes that something needs to be done about this
25 problem, but, as I say, whether that has moved a
26 further stage in recent months, I am afraid I could
27 not say. I do know that my successor and others
28 still feel it is a very awkward proposition, and that
29 it has not yet been adequately covered.

30 THE CHAIRMAN: Aside from the difficulty



LORD CORBOLD: Yes.



1 of drafting was any policy more or less decided upon,
2 generally, so as to deal with the situation?

3 LORD COBBOLD: No, I would say it had not
4 been. The first difficulty is in the question of
5 defining banks, and seeing who could be brought under
6 various types of umbrella. Nobody has yet devised a
7 method of --

8 THE CHAIRMAN: We have had a variety of
9 definitions of things given us. I do not know whether
10 you have another one.

11 LORD COBBOLD: I think, actually, our main
12 definition is that a bank is anybody who the Bank
13 of England, with the approval of the treasury, says
14 is a bank.

15 COMMISSIONER GIBSON: In your thinking about
16 it, Lord Cobbold, what are the main considerations?
17 Would they centre around the nature of the deposits and
18 the rate of turnover? Are those factors in your
19 thinking?

20 LORD COBBOLD: In thinking about near banks?

21 COMMISSIONER GIBSON: Yes.

22 LORD COBBOLD: Yes, I have been thinking
23 on both the deposit side and the lending side. We
24 have been seeking to find something which would bring
25 in, by and large, anybody who competed on either
26 of those sides with the clearing banks which are
27 subject to our regulations. That is the line of
28 thought which we have pursued, without any startling
29 success up to date.

30 THE CHAIRMAN: Suppose you have got that far,



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THE CHAIRMAN: Suppose you have got that far,



1 what sort of steps would you consider taking; what sort
2 of controls?

3 LORD COBBOLD: You could apply something
4 like a special deposit system -- not the same
5 deposit arrangement as is applied to the clearing banks,
6 but you could apply some sort of special deposit system,
7 probably, to the near banks. You could also apply
8 some sort of control by the central authority on their
9 general policy once you definitely regard them as
10 banking institutions. In that case the provisions
11 of the Bank of England Act would apply and you could
12 give directions with the treasury's approval so that
13 they would be brought in under the general umbrella
14 of control. I think those are the first two things.



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of control. I think those are the first two things.



1 THE CHAIRMAN: Before we leave that, I
2 suppose a great many of these near banks have substantial
3 dealings with the clearing banks, do they?

4 LORD COBBOLD: They do.

5 THE CHAIRMAN: They depend to some
6 considerable extent upon loans, so to that extent they
7 might be affected by bank policy generally.

8 LORD COBBOLD: That is certainly so.

9 THE CHAIRMAN: Or is that so? We have had
10 different views expressed.

11 LORD COBBOLD: That is certainly so in a
12 large number of cases; and, of course, there is an
13 indirect sanction there which operates more in times
14 when deposits are being withdrawn than when deposits
15 are being added to; but there is a certain amount of
16 indirect saction there. Also, on the other side of
17 the balance sheet, as it were, that adds to the friction
18 in some ways.

19 COMMISSIONER GIBSON: In thinking about
20 near banks, how far do you go in the financial system?
21 Do you get them out of savings institutions?

22 LORD COBBOLD: Not to the building societies
23 or savings banks. That is pretty clearly regulated
24 and defined, and their practice is well understood.
25 I do not think the clearing banks would feel they are
26 taking any unfair advantage of the rules to be applied
27 to the regular banking system.

28 THE CHAIRMAN: What about the trust companies?
29 Do they do very much in the way of deposit business?

30 LORD COBBOLD: Not the trust companies



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1 themselves, as a general rule, no.

2 COMMISSIONER BROWN: You mentioned a bank
3 or an institution that by name was called such by the
4 Bank of England. Is it a correct assumption they have
5 to request this? It is not a question of your being
6 able to say that such and such an institution is a
7 bank?

8 LORD COBBOLD: This has never been tested
9 in the courts. I think you will get various legal
10 opinions on this.

11 COMMISSIONER BROWN: But thus far it has
12 always been at their request?

13 LORD COBBOLD: Yes, I would say it has
14 always been at their request. There is no doubt, in
15 a great number of cases, that any member of a clearing
16 banking committee and members of a number of other
17 committees are automatically regarded as banks. There
18 is the Board of Trade legislation in the matter
19 requiring returns that also affects this. There is
20 some legal doubt as to exactly who is a bank and who
21 can be given directions by the Bank of England; and
22 this has not yet been tested in the courts, and there
23 is a certain number of marginal cases. There has been
24 a good deal of discussion as to whether there ought
25 to be some new legislation. This was a matter the
26 Radcliffe Committee gave a good deal of attention to,
27 as to whether there should be some new legal definition.

28 THE CHAIRMAN: For you it would be very simple
29 to have a new legal definition: You could decide what
30 to put into it, and have it. But for us there are

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to put into it, and have it. But for me there are



1 constitutional problems that arise. and the meaning of
2 a bank has not been fully judicially defined.

3 LORD COBBOLD: You say, Mr. Chairman, it
4 would be easier for us. I have gathered from my legal
5 friends in the U.K. that it would not be all that easy.

6 THE CHAIRMAN: Oh no, but you have not the
7 constitutional difficulty.

8 LORD COBBOLD: Certainly, no.

9 THE CHAIRMAN: I say that because the
10 federal parliament here could not do that.

11 LORD COBBOLD: This is a subject which I
12 have discussed frequently, at great length, with my
13 Australian colleague too.

14 THE CHAIRMAN: There is the same difficulty
15 there?

16 LORD COBBOLD: Yes, there I think banking
17 powers lie with the states.

18 THE CHAIRMAN: The banking powers lie with
19 the federal authorities here, but the question arises
20 as to what is the limit of that authority.

21 LORD COBBOLD: Subject to correction, I think
22 in Australia the banking powers lie with the states,
23 and that in Australia it is even more complicated than
24 it is here. It is by no means just a U.K. or Canadian
25 problem, but a world-wide one that is giving a lot of
26 trouble.

27 COMMISSIONER MACKINTOSH: On this point,
28 my recollection of the Radcliffe Committee report is
29 that on the whole they rather dismissed the near banks
30 as being not too serious a problem. Do I interpret you



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1 correctly as not agreeing quite with that?

2 LORD COBBOLD: I think they were hunting
3 around but did not find any great solution and that
4 they, therefore, hoped it was a matter which would
5 settle itself or which would not obtrude too violently.
6 I do not think I felt the same confidence.

7 COMMISSIONER MACKINTOSH: Thank you.

8 THE CHAIRMAN: Is the chief offender the
9 finance company? In view of the relative amount of
10 business that they do and the effect upon the economy
11 that they might have, is that so?

12 LORD COBBOLD: Yes, but it varies a bit from
13 time to time. That is what we would have called the
14 hire-purchase company?

15 THE CHAIRMAN: Yes.

16 LORD COBBOLD: That was a most difficult
17 subject, certainly at one time. More recently some
18 parts of that industry got into difficulties here and
19 there, and I think the difficulty from that side
20 decreased a little. Then, there is a number of people
21 quite outside the market. Even going down to travel
22 agencies and stores, very widely they have been taking
23 deposits and giving what is term credit, but not
24 exactly in the form of a hire-purchase contract. It
25 spreads pretty widely at one time and another, but
26 certainly it stems mainly from finance and hire-purchase
27 companies.

28 COMMISSIONER LEMAN: I believe you said
29 that there is a number of marginal cases. Are there
30 institutions in England that accept chequing deposits,



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COMMISSIONER LEWIS: I believe you said

that there is a number of marginal cases. Are there

institutions in England that accept cheques deposited,



1 as such, that are not considered banks and do not
2 now come under the jurisdiction?

3 LORD COBBOLD: I would not know exactly
4 what "chequing deposits" would mean in our terms.

5 COMMISSIONER LEMAN: Demand deposits.

6 LORD COBBOLD: Yes.

7 THE CHAIRMAN: That is what you meant when
8 you used the word "deposits" -- "demands"?

9 LORD COBBOLD: Yes.

10 THE CHAIRMAN: If there are no more questions
11 on this we shall proceed to number 4, the effects of
12 monetary policy on the domestic market; the relation-
13 ship of bank rate to interest rates, generally; the
14 relation of monetary policy to debt management.

15 LORD COBBOLD: If I might just say a word,
16 first, about general objectives of monetary policy.
17 I do not want to go into this at great length because
18 you will have many more competent witnesses than myself,
19 and many witnesses who know much more about the Canadian
20 scene. I would just like to say, however, that I think
21 there is a considerable measure of unanimity in the
22 central banking profession, and more widely, about
23 objectives. I find, for myself, that I am unable to
24 improve on the words used by the present governor
25 of the Bank of Canada, Mr. Rasminsky, in his statement
26 of August 1st, 1961, in which he said:

27 "... the broad aim of the community
28 is to attain, to the maximum extent possible,
29 certain generally accepted objectives: High
30 level employment, high stability and



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1 sustained economic growth. A flexible
2 monetary policy is an essential element in
3 the total blend of policies directed to these
4 ends. In a situation characterized by
5 large unemployment and unused capacity,
6 monetary policy should be directed to
7 encouraging the use of credit. On the other
8 hand, if the economy is approaching a
9 condition of full stretch, policy should be
10 directed towards discouraging the use of
11 credit."

12 As I say, as a general statement that seems to me to
13 put it very concisely, and I find myself in entire
14 agreement with it.

15 The other important thing to underline
16 right away, I think, is that monetary policy is
17 continuously interlocked with fiscal policy -- using
18 the word "fiscal" in its broadest sense, to cover the
19 whole range of government and local authority expenditure,
20 taxation and borrowing, which can never be kept in
21 separate compartments without regard one to the other.
22 The general line of monetary and fiscal policy must
23 be complementary or at least not contradictory. And
24 the complaint of most central bankers, including myself,
25 over the post-war years has been that they have been
26 left to carry too heavy a part of the battle against
27 inflation, with insufficient support from the fiscal
28 side. I have always maintained that an attempt to
29 stem inflation and keep prices steady, by credit
30 controls and interest rate policy alone, is doomed to



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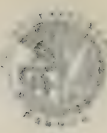
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2 are working the other way. I would judge myself --
3 though we have fortunately not yet had to face this
4 position since the war -- that an injection of credit
5 and low interest rates would be even less able, all
6 by itself and without support in other fields, to
7 counteract a serious recession. But given an agreed
8 general line of policy, credit controls and interest
9 rate policies have proved themselves in the post-war
10 period: They are much more flexible than taxation
11 and long-term public expenditure; they can be adapted
12 fairly frequently and pushed a little now in one
13 direction and now in the other as the economic wind
14 veers. The metaphor of driving a car along the road
15 has been criticized as being stale, but I still think
16 it the most descriptive. It makes no sense to drive
17 along the highway with one foot continuously on the
18 brake and the other foot continuously on the accelerator;
19 and this is what happens if you have a restrictive
20 money policy and an expansionist budget, or the other
21 way around. On the other hand, once you have decided
22 the sort of average speed your engine and the state
23 of the road can take, it makes every sort of sense to
24 use a touch of the brake at one moment and a touch of
25 the accelerator at another. But there is another
26 limitation to the effectiveness of monetary measures
27 which is often forgotten, unless the measures are savage
28 and violent -- and savage and violent measures should
29 be reserved for crisis conditions because they upset
30 the economy and disturb healthy growth -- they take time



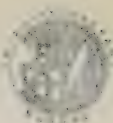
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1 to work through. You cannot expect a gentle change
2 in the emphasis of credit policy to take effect in
3 a week or two. Our own experience in the United Kingdom
4 is that it takes something like six months before a
5 switch from easy to tight conditions, or the reverse
6 movement, works right through the system.

7 Under the United Kingdom practice, which
8 differs, of course, from other practices, the commercial
9 bank lending rates are directly related to the bank
10 rate, and I think that is a very important point and
11 a considerable difference between the British practice
12 and many other practices, one which means the bank
13 rate is something more immediately real than it is
14 in a number of other markets. That is to say, the
15 majority of commercial bank lending arrangements are
16 expressed, so far as the rate of interest is concerned,
17 as the bank rate plus one or the bank rate plus one
18 and a half, varying with the minimum. So, if the bank
19 rate is at all on the upward swing -- probably any-
20 where upwards of $3\frac{1}{2}$ -- it immediately impinges on the
21 direct charge of the lending rate of the commercial
22 banking system. That is to say, when, for example,
23 the bank rate was increased by two points at one of
24 our more difficult moments, that automatically increased
25 the charge of the banking community's lending rates
26 to practically all their customers by 2 per cent.
27 That is an immediate and direct relationship.

28 A change in the bank rate will also, under
29 our arrangements, immediately affect the short-term
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1 with the clearing banks' deposit rate, which is, again,
2 related to the clearing banks' lending rate and,
3 therefore, immediately affected by a change in the
4 bank rate. That is so far as short-term money rates --
5 treasury bills and short-term government securities
6 maturing within one, two or three years, or thereabouts,
7 and perhaps up to five years, are concerned.

8 So far as long-term interest rates are
9 concerned, the position is distinctly different. On
10 the text book, of course, an increase in bank rate
11 ought to put up rates right through the whole picture,
12 and a decrease in the bank rate ought to bring them
13 down right through the whole picture. As a matter of
14 fact, that has not always proved the case, and there
15 have been occasions when an increase in the bank rate
16 has had the opposite effect, in the long-term
17 rates, merely because the factor of confidence enters
18 so largely into this, and when, for example, there has
19 been a time when things have been drifting a little
20 and not enough is being done by the authorities to
21 keep the thing in hand, long-term gilt-edged prices
22 have been sagging. It has several times happened that
23 firm action, including a strong increase in the bank
24 rate, has actually improved long-term prices from
25 a confidence angle, and have, therefore, made long-term
26 borrowing a touch cheaper instead of a touch more
27 expensive. Those are, as a rule, temporary, and by and
28 large, the bank rate, under our system, does have some
29 influence right through the system but much more
30 at the short end than at the long end.



with the clearing banks' deposit rate, which is, again, related to the clearing banks' lending rate and, therefore, immediately affected by a change in the bank rate. That is as far as short-term money rates -- treasury bills and short-term government securities, maturing within one, two or three years, or elsewhere, and perhaps up to five years, are concerned.

So far as long-term interest rates are concerned, the position is distinctly different. On the text book, of course, an increase in bank rate ought to put up rates right through the whole picture, and a decrease in the bank rate ought to bring them down right through the whole picture. As a matter of fact, that has not always proved the case, and there have been occasions when an increase in the bank rate has had the opposite effect, in the long-term rates, merely because the factor of confidence enters so largely into this, and when, for example, there has been a time when things have been drifting a little and not enough is being done by the authorities to keep the thing in hand, long-term gilt-edged prices have been sagging. It has several times happened that firm action, including a strong increase in the bank rate, has actually improved long-term prices from a confidence angle, and have, therefore, made long-term borrowing a touch cheaper, instead of a touch more expensive. Those are, as a rule, temporary, and by and large, the bank rate, under our system, does have some influence right through the system but much more at the short end than at the long end.



1 If I may turn, just for a moment, to the
2 relationship between monetary policy, the bank rate,
3 etc., and debt management, which I have just touched
4 on in those last remarks. The fundamental objective
5 of debt management is to ensure that government can
6 borrow for its requirements at a reasonable rate of
7 interest and that maturities are so spread as not to
8 embarrass the authorities at any one time. Debt
9 management is to be considered an important part of
10 wider fiscal policy, and needs, therefore, to be
11 harmonized with monetary policy. Here too there may
12 often be a conflict between objectives. Whilst the
13 importance of borrowing as cheaply as possible must
14 always be borne in mind, there are very often situations
15 when this objective is over-ridden by the necessity of
16 keeping in line with monetary policy when it is directed
17 towards tighter money conditions. Practice in the
18 United Kingdom, where the authorities intervene
19 regularly and sometimes heavily in the gilt-edged
20 market, has been to steady prices, to restrain movements
21 and occasionally to nudge the market in one direction
22 or the other. It has never been United Kingdom
23 practice to attempt to reverse a strong market trend
24 in the gilt-edged market. That is a point which was
25 very much to the fore in our discussions with the
26 Radcliffe Committee, as some members of your Commission
27 may remember. The general policy -- or I would rather,
28 perhaps, say the general operational technique of the
29 Bank of England over the past few years has been that
30 we are generally concerned to purchase in the market



If I may turn, just for a moment, to the relationship between monetary policy, the bank rate, etc., and debt management, which I have just touched on in those last remarks. The fundamental objective of debt management is to ensure that government can borrow for its requirements at a reasonable rate of interest and that maturities are so spread as not to embarrass the authorities at any one time. Debt management is to be considered an important part of wider fiscal policy, and needs, therefore, to be harmonized with monetary policy. Here too there may often be a conflict between objectives. Whilst the importance of borrowing as cheaply as possible must always be borne in mind, there are very often situations when this objective is over-riden by the necessity of keeping in line with monetary policy when it is directed towards tighter money conditions. Practice in the United Kingdom, where the government has been so successful, is to regulate the market, has been to steady prices, to restrain movements and occasionally to nudge the market in one direction or the other. It has never been United Kingdom practice to attempt to reverse a strong market trend in the gilt-edged market. That is a point which was very much to the fore in our discussions with the Redcliffe Committee, as some members of your Committee may remember. The general policy -- or I would rather perhaps, say the general operational technique of the Bank of England over the past few years has been that we are generally concerned to purchase in the market



1 the next maturities of government stock, so as to
2 ensure a successful conversion. That is to say that
3 in the year or two, and more particularly in the
4 months preceding a maturity date, the issue department
5 will be guying stock in the market so that when the
6 time comes to repay or convert that particular line
7 the issue department will hold as high a percentage
8 as possible of that particular loan so as to make
9 the conversion operation an easier one. The practice
10 has also been, particularly since the war, that new
11 long-term government issues are largely taken up,
12 in the first instance; by the issue department of the
13 Bank of England and sold gradually over succeeding
14 weeks and months. We naturally try, so to speak, to
15 clear our book of a new loan within a reasonable time
16 and not to get stuck up with it indefinitely; and we
17 always like to have the great majority of an issue sold
18 on the market before making another government
19 long-term issue. The reason for that process is
20 that the market just cannot absorb on one day
21 £ 200 million or £ 300 million of government stock,
22 or whatever it might be.

23 We have at times had a tap loan -- we had
24 a tap loan all through the war -- but generally speaking,
25 in these times and conditions, we have found a tap
26 loan inconvenient because it pegs the level of
27 long-term interest rate and rather prejudices one's
28 flexibility of action in later months; and we have
29 generally decided that this more flexible arrangement, by
30 which the issue department takes the stock on its book and



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Nethercut & Young

-4030-

Toronto, Ontario

1 in fact leaves the stock on tap to the market in the
2 succeeding months, is much more flexible because it
3 can alter that tap and can close it at any moment
4 and can increase or decrease the volume of sales, and
5 it can adjust the price at which it is prepared to
6 sell that stock in conformity with the general movement
7 of the money rates.



WATER TAP
INSTRUCTIONS

In fact, leave the stop at all times in the
position shown, as this will prevent the
tap from being closed at any moment
and can be opened or closed at any time
if the stop is turned to the right or
left. This is especially true in the case
of the water tap.

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1 I don't say that will necessarily remain the way in
2 which we do it, and I do not say it may not in certain
3 conditions prove convenient to make an issue and
4 expect it to be taken up outside along one day, or
5 we may find it convenient at certain times to revert
6 to the pure tap loan method. This method we have
7 adopted has proved very successful subject to the fact
8 that one does not allow the issue department book to
9 get too full of any particular security so that that,
10 in fact, becomes gummed up and it prejudices your
11 subsequent operations.

12 In the early days after the war our problem
13 was we were left with a very heavy floating debt,
14 and our internal technical problem was to get that
15 funded into a more manageable permanent or semi-
16 permanent debt structure. In the event we had to
17 finance a good deal of that short, partly because it was
18 not practicable to fund it long and partly because at
19 times during the period rates had been on the high
20 side, and we did not wish to fund too long at too high
21 rates. The effect of that has been that in every year
22 for the last ten years, and it will be the position in
23 every year pretty well for the next period, there has
24 been a pretty heavy maturity to be dealt with that
25 arises mainly out of the funding of this short-term
26 floating debt which we were left with at the end of
27 the war. That has been a very constant and difficult
28 problem never very far away from our minds, because
29 when one gets rid of a 1958 maturity one observes
30 there is something more coming up in 1959, and so on,



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2 I say that is a relic of war-time finance
3 very largely, and on the whole we have managed to spread
4 that out in a way which though it causes us continuous
5 thought is, I think, not an undue embarrassment.

6 It might be perhaps of interest as an obiter
7 dictum to the Commission: I occasionally dip into
8 Clapham's History of the Bank of England, and if one
9 reads the chapters relating to the period immediately
10 after the Marlborough wars or after the Napoleonic wars
11 you find exactly the same page after page: "The governor
12 and deputy governor called on the Chancellor to discuss
13 the problem of funding the floating debt", and it
14 happens again and again throughout the history, and
15 it is extraordinary the degree to which the words
16 used by our predecessors a century and two centuries
17 ago are precisely in the same terms as the words which
18 we have been using in Whitehall since the last war.

19 I think that about covers that, sirs, for
20 the moment.

21 THE CHAIRMAN: You mentioned the aims of
22 monetary policy. Of course, I think it no doubt is
23 quite obvious that at times there is the conflict between
24 one and another, between price stability on some occasions
25 and perhaps full employment on the other. Do you find
26 any special priority that should be attached to one of
27 these aims over the other when there is a conflict?

28 LORD COEBOLD: I would agree, sir, entirely
29 that there is a frequent conflict in that. My own view
30 is that it requires a continuous exercise of judgment.



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1 and that at one time one thing may be more important,
2 and that at another time another aspect may be important,
3 and really that is what the people in my late profession
4 have, therefore, to try to weigh up at one time or another:
5 to which of those they should attach the most importance.

6 I think I would just say this, and certainly
7 this is true of general policy in the United Kingdom:
8 I think the one thing that most people in authority in
9 the United Kingdom at this moment, most of whom lived
10 through the 30's in their earlier years, are determined
11 not to see again is any high level of unemployment.
12 I would think in many people's minds, and as a general
13 proposition that would go for me, I think I would tend
14 to put that as the highest priority of the lot.

15 THE CHAIRMAN: When you contemplate full
16 employment it can hardly be said that monetary policy
17 alone can accomplish that?

18 LORD COBBOLD: Certainly.

19 THE CHAIRMAN: And as you have already
20 mentioned, that would have to be in conjunction with
21 fiscal policy or some other policies which may be beyond
22 the strict purview of monetary policy.

23 LORD COBBOLD: If I were to put it negatively,
24 I should regard anything like mass unemployment as the
25 greatest failure on behalf of the fiscal and monetary
26 authorities of any failure they could make under present
27 circumstances. By that I do not mean until tomorrow:
28 I mean quite some while ahead. I should not regard it
29 as any achievement of the fiscal and monetary authorities
30 to keep the level of employment up by methods and means



1 which would quite inevitably lead to mass unemployment
2 in years to come. I think there is quite often a danger
3 in some thinking to think too short on this subject.

4 THE CHAIRMAN: On the other hand, a great deal
5 would depend on the cause of the particular unemployment
6 situation?

7 LORD COBBOLD: What I really had in mind was
8 that it is probably easy to keep full or fullish employ-
9 ment by a very easy money policy for a very short time;
10 let your prices go up and not bother about your
11 competitiveness. However, as certain as night follows
12 day that will lead you into trouble in your balance of
13 payments situation and competitive situation and is bound
14 to cause unemployment at a later stage, and you are
15 no whit further forward, and you are somewhat further
16 backward. I think you have to keep the longish view
17 on that.

18 THE CHAIRMAN: There are certain structural
19 changes in the economy from time to time which might
20 give it a new direction which monetary policy would have
21 very little to do with -- you could hardly rely on
22 monetary policy to have much effect?

23 LORD COBBOLD: I would agree. I think it will
24 in almost all situations have some effect. The amount of
25 effect it will have depends normally on the different
26 situations. I would think an extreme monetary policy
27 will always have an effect. A very tight monetary policy
28 and very high interest rates will always have a consider-
29 able effect; and a very easy monetary policy and very
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1 any situation which I can envisage. However, it certainly
2 is true what one would call moderate adjustments will
3 have much more effect in some circumstances than in
4 others.

5 THE CHAIRMAN: When you speak of the stability
6 of prices you have contemplated a certain fluctuation.

7 LORD COBBOLD: Surely.

8 THE CHAIRMAN: Within limits.

9 LORD COBBOLD: Yes.

10 THE CHAIRMAN: I understand in Sweden they
11 had a four per cent inflationary increase from year to
12 year ever since the last war. They do not seem to be
13 very much concerned about that.

14 LORD COBBOLD: No.

15 THE CHAIRMAN: Is there any rule that you
16 can apply to the sort of fluctuation of prices that would
17 be in keeping with --

18 LORD COBBOLD: I think only the rather general
19 rule that one would not like to see it run at all too
20 quickly and not like to see it out-distance the increase
21 in productivity. I think we must all face the fact that
22 at least since the war -- certainly in the United
23 Kingdom and probably all western countries -- pressures
24 have been inflationary pressures, and what we have been
25 concerned to do is try and damp down a bit when we have
26 seen opportunities without doing damage to economic
27 growth.

28 THE CHAIRMAN: That is another point I was
29 going to mention: Sustained economic growth is another
30 problem which on the face of it might involve some



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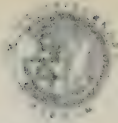
2 LORD COBBOLD: Necessarily some. When I
3 talk about price stability, that really means, except
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6 banking colleagues around the world would agree that in
7 practice since the war that has meant trying to keep
8 the upward movement of prices from getting out of hand.
9 It has not involved conscious efforts to keep prices up.

10 THE CHAIRMAN: When was the last time you
11 might say there was reasonable stability of prices?

12 LORD COBBOLD: I am afraid before I was in
13 the business.

14 COMMISSIONER LEMAN: Lord Cobbold, you have
15 used the metaphor, and I would like to take a little drive
16 with you if you are willing to take the wheel: Do you,
17 in fact, in the United Kingdom in your discussions with
18 government set quantitative values on these various
19 objectives in terms of unemployment, rate of growth and
20 price stability? Can you do a little bit of both short-
21 term and long-term planning in terms of actual figures --
22 set yourself targets?

23 LORD COBBOLD: I would not say we set ourselves
24 actual targets in that sense, but in every discussion on
25 this subject which I recollect all these points have
26 been raised and, so to speak, have been put from different
27 positions at the table and from different points of
28 view. I think they have always been raised and at
29 different times a different degree of importance has
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INTERNATIONAL MONETARY FUND

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1 I would repeat, however, that over the period
2 in most people's minds the fear of possible unemployment
3 on any large scale tends to be the dominating one
4 except for immediate pressures on the balance of payments
5 and the foreign exchanges which I was going to come to
6 in more detail a little later. However, of the general
7 considerations running through there has always been
8 emphasis on keeping as much price stability as possible;
9 always emphasis on maintaining industrial expansion and
10 growth. I think perhaps I should put it that as the
11 chief background fear or concern in people's minds
12 remains the unemployment one. I think I might probably
13 say that is a very great distinction from the attitude
14 taken by some of our continental central banking friends,
15 particularly in the countries where they suffered very
16 heavy inflation, where I should say that the major
17 concern at the back of almost everybody's minds has
18 been to avoid the risk of inflation again at any cost.
19 That is in those countries where savings have disappeared
20 once or twice in a generation, and there there is
21 no doubt that whilst with us, and perhaps with you
22 and in the United States unemployment has been the
23 dominant of these factors, in certain central European
24 countries the avoidance of inflation has been the
25 dominant one in their minds.

26 COMMISSIONER LEMAN: In talking about un-
27 employment you must set yourself targets in a sense of
28 what you consider an acceptable percentage or not an
29 acceptable percentage?

30 LORD COBBOLD: I think that varies from time

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1 to time, and the exact percentages would be much more
2 a political consideration than a central banking
3 consideration.

4 COMMISSIONER MACKINTOSH: Would you carry
5 that distinction further and say that control of inflation
6 or stability of the price level was a peculiar concern
7 of the central bank in that it could do more about it
8 than it could do about unemployment?

9 LORD COBBOLD: Yes, I would say one is
10 thinking about it every day more because it is the
11 material of one's everyday business. Speaking for
12 myself, I think I would repeat that if I had gone out of
13 the bank and seen mass unemployment I should have thought
14 I had done worse if I had gone out and seen almost any
15 other condition. I think it is something which all our
16 generation has very much in the back of its mind.

17 COMMISSIONER MACKINTOSH: I certainly agree
18 as an economic objective, but provided fiscal policy
19 has gone ahead, can the bank do, actually, very much?

20 LORD COBBOLD: No, I don't think so. I was
21 asked what was the prior thing at the back of people's
22 minds, and I think it is that. However, in all our
23 day-to-day thinking I think one is much more concerned
24 with the other things: Stability and keeping a reason-
25 able rate of growth and expansion.

26 COMMISSIONER MACKINTOSH: Not that they are
27 more important?

28 LORD COBBOLD: No, but they are more closely
29 associated with the practical things one can do from
30 day-to-day. I have, myself, always looked with the



1 greatest interest, not so to speak as a guider of
2 policy, but as an indication at the graph of unfilled
3 vacancies and employment. It has often seemed to us when
4 that graph crosses it shows the thing is beginning to
5 move in the other way. You are familiar with the graphs
6 I mean, I am sure.

7 COMMISSIONER MACKINTOSH: Yes.

8 COMMISSIONER LEMAN: In more precise terms,
9 though, I suppose at budget time there is discussion
10 between government and bank about the average speed
11 of the engine and the state of the road: Does it get down
12 to brass tacks, or only very general?

13 LORD COBBOLD: Not only at budget times;
14 continuously throughout the year, in various forums
15 between the chancellor and the governor, between the
16 officials, and quite often at a round-table meeting with
17 the various people concerned; by no means only on budget
18 day -- and they get very much down to brass tacks in
19 terms of what one can do about it.

20 COMMISSIONER LEMAN: I was perhaps thinking
21 of something different. I can understand where you would
22 keep talking about these things all through the year, but
23 at budget time is it more possible to set precise targets
24 for the fiscal year?

25 LORD COBBOLD: More possible because that
26 is the only time it can be done; that is why I was saying
27 monetary policy tends to be more flesible because you
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for the year, it is more difficult to change it.



1 has to take a definite view for the year ahead. In
2 regard to the sort of machinery I was speaking about just
3 now, you can take account of movements through the year
4 or at any time, and consider the measures, which must
5 be largely monetary measures, you can take next week
6 or next month .



The purpose of this report is to provide a summary of the work done during the year 1954. The report is divided into two main parts: a general summary of the work done and a detailed account of the work done in each of the four quarters. The general summary is given in the first part of the report and the detailed account is given in the second part. The work done during the year 1954 has been very successful and has resulted in a number of important discoveries. The work done in each of the four quarters is described in detail in the second part of the report. The work done during the year 1954 has been very successful and has resulted in a number of important discoveries. The work done in each of the four quarters is described in detail in the second part of the report.

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1 COMMISSIONER LEMAN: Is the government
2 willing to consult with the bank on actual figures on
3 what they will shoot for in the way of expenditures,
4 borrowing, et cetera, and see if the bank feels
5 that that will fit in properly with what it thinks
6 a proper monetary policy?

7 LORD COBBOLD: It has been recent practice
8 that the Chancellor would bring us pretty fully into
9 that picture, yes.

10 COMMISSIONER GIBSON: I would like to ask
11 you a question, Lord Cobbold, about full employment
12 and growth as two objectives. It is frequently the
13 case that people seem to think that this is the same
14 thing, but in the United Kingdom in the post war
15 period you have had a very high rate of employment
16 most of the time, but in recent years not a very high
17 rate of growth. Now, do you see any conflict or
18 basic difference between these two objectives?

19 LORD COBBOLD: In the sense that
20 I should have been happier if I had seen a larger
21 rate of growth over the last few years?

22 COMMISSIONER GIBSON: Do you think there
23 is any conflict between the objective of a fairly high
24 rate of growth and an immediate objective of full
25 employment?

26 LORD COBBOLD: Certainly; if you get to
27 an overfull employment stage there certainly is, and
28 we have had that once or twice with all the familiar
29 things, a bottleneck effect on prices, and so on,
30 and there have been certainly several periods within the



WATER LEMAN: Is the government

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what they will shoot for in the way of expenditures.
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COMMISSIONER GIBSON: I would like to ask
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thing, but in the United Kingdom in the post war
period you have had a very high rate of employment
most of the time, but in recent years not a very high
rate of growth. Now, do you see any conflict or
basic difference between these two objectives?

LORD GOSBOLD: In the sense that
I should have been happier if I had seen a lower
rate of growth over the last few years?

COMMISSIONER GIBSON: Do you think there
is any conflict between the objective of a fairly high
rate of growth and an immediate objective of full
employment?

LORD GOSBOLD: Certainly; if you get to
an overfull employment stage there certainly is, and
we have had that once or twice with all the familiar
things, a bottleneck effect on prices, and so on,
and there have been certainly several periods within the



1 last twelve years where there has been definite over-
2 employment and definite shortage of labour, particularly
3 skilled and semi-skilled labour, which has impeded
4 growth.

5 COMMISSIONER GIBSON: Would you say,
6 sir, that the Bank of England's policies have had
7 a major part to play in this full employment picture
8 which you have had most of the time, or have
9 you mainly been concerned with preventing it
10 from going into another situation?

11 LORD COBBOLD: I think we have been
12 mainly concerned with combatting the inflationary
13 situation, because I think all the pressures since
14 the war have been inflationary pressures and unemploy-
15 ment has been a distant bug-bear; it has never been
16 a very present danger. I think it is probably true
17 that all the time that I was deputy governor or
18 governor one's preoccupation was how to cope with
19 pretty consistent inflationary pressures and pretty
20 definite risks of exchange difficulties and balance
21 of payment difficulties around the corner. These
22 have been the current problems all the time.

23 COMMISSIONER MACKINTOSH: You don't feel
24 that that is now changed?

25 LORD COBBOLD: I wouldn't know, sir.

26 COMMISSIONER LEMAN: You did make a
27 point that the fiscal policy was extremely closely
28 interrelated with the monetary policy. Also in a
29 discussion you talked about the fields where one body
30 could take the initiative and the other one act as



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1 counsel or moderator, perhaps, and in other fields
2 it would be the other way around. Now, would you
3 go so far as to say they are so interlocked that one
4 could go so far as to say that the government could
5 establish after consultation, say, with the bank and
6 the monetary authorities what they will go for as a
7 programme, but thereafter should leave to the monetary
8 authority all matters of maturities and interest rates,
9 et cetera.

10 LORD COBBOLD: No, I would prefer to
11 see continuous consultation myself, because I think
12 the general picture changes a lot all the time, and
13 I think if you were to ask the government to establish
14 something at a given date and then consider two months
15 after that what you were going to do about it, I would
16 much rather know what the government is thinking on the
17 same date as I was taking the subsequent action. I
18 wouldn't like to see that too static.

19 COMMISSIONER LEMAN: You visualize it as
20 much a matter of give and take all the time?

21 LORD COBBOLD: Yes, all the time.

22 COMMISSIONER LEMAN: And not too much
23 separation?

24 LORD COBBOLD: No.

25 COMMISSIONER LEMAN: Earlier you also
26 talked about the government broker, what he does --
27 perhaps I am getting ahead of myself and getting into
28 techniques here, but to what extent does the government
29 broker know exactly what your position is in a situation?
30



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 could go so far as to say that the government could
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 see continuous consultation myself, because I think
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 something at a given date and then consider two months
 later that what you were going to do about it, I would
 much rather know what the government is thinking on the
 same date as I was taking the subsequent action. I
 wouldn't like to see that too drastic.

COMMISSIONER LEAH: You visualize it as
 when a matter of give and take all the time?
 LORD CORBOLD: Yes, all the time.
 COMMISSIONER LEAH: And not too much.

LORD CORBOLD: No.
 ...
 talked about the government broker, what he does --
 perhaps I am getting ahead of myself and getting into
 technicalities here, but to what extent does the government
 broker know exactly what your position is in a situation?



1 Is he fully informed?

2 LORD COBBOLD: He is fully informed
3 immediately before we act. Not by any means is it
4 necessary to inform him of forward policy.

5 THE CHAIRMAN: We will continue this
6 after lunch. We will adjourn now until 2:30 this
7 afternoon.

8
9 ---LUNCHEON ADJOURNMENT

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1 ---ON RESUMING AT 2:30 P.M.

2 THE CHAIRMAN: We shall now resume.

3 COMMISSIONER LEMAN: Lord Cobbold, to resume
4 where we left off before lunchtime, we were talking
5 about the subjects which you put under section 4 here,
6 and one of them -- I will not necessarily take them in
7 order -- one of them is the relationship of debt
8 management to monetary policy, and I asked you a couple
9 of questions about that and I would like to ask you
10 a couple more.

11 In the handling of government issues, could
12 you give us a brief run-down on the curriculum that is
13 used for getting new government data to the public?

14 LORD COBBOLD: Could you develop that question
15 a little bit? The curriculum that is used --

16 COMMISSIONER LEMAN: I understand that the
17 government primarily takes the initiative in this
18 deal and decides how much it needs and consults with
19 the bank; the bank really manages these things?

20 LORD COBBOLD: Yes. In fact, in practice
21 the government will decide on their requirements.
22 The practice is for the bank to be considering
23 all the time how we might best meet the government's
24 needs, what would be a suitable moment for a conversion,
25 what would be a suitable moment for moving into
26 the long-term market, and the normal practice
27 would be for us to say to the government,
28 "Well, it looks as if now would be a good time
29 to deal with that one. We know that

30



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about the subjects which you put under question 4 here.
and one of them -- I will not necessarily take them in
order -- one of them is the relationship of debt
management to monetary policy, and I asked you a couple
of questions about that and I would like to ask you
a couple more.

In the handling of government issues, could
you give us a brief run-down on the curriculum that is
used for getting new government data to the public?
FORD COBOLD: Could you develop that question
a little bit? The curriculum that is used --

COMMISSIONER LEWIS: I understand that the
government primarily takes the initiative in this
deal and decides how much it needs and consults with
the bank; the bank really manages these matters?
FORD COBOLD: Yes, in fact, in practice
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The practice is for the bank to be considering
all the time how we might best meet the Government's
needs, what would be a suitable money for a conversion,
what would be a suitable moment for moving into
the long-term market, and the normal practice
would be for us to say to the Government,
"Well, it looks as if now would be a good time
to deal with that one. We know that



1 your requirements are such and such and we would suggest
2 making a move now," or, alternatively, "Now doesn't look
3 like a good time and we will carry on on short-term
4 financing for a while and it would probably be better
5 to make it next January or next February," and we should
6 then agree on that general principle with the government
7 and they would say, "O.K., carry on and let us know what
8 specific suggestions you have," or alternatively they
9 might say, "We would rather leave it for a bit and not
10 deal with it until a bit later." We should then get on
11 with our initial discussions with the government brokers
12 and make up our minds what sort of financing is the most
13 appropriate in all the circumstances and then discuss
14 it further with the government and eventually, when
15 we agreed to the general lineup of what we wanted to
16 do, the governor of the bank would have a meeting on
17 the final day with the government brokers, settle what
18 terms were appropriate and advise the treasury to that
19 effect, and the thing would go ahead.

20 COMMISSIONER LEMAN: Is the relationship
21 with the government brokers primarily between them and
22 the bank or between them and the treasury?

23 LORD COBBOLD: Between them and the bank
24 entirely; it is an operational relationship. The
25 treasury don't operate in that. The treasury are
26 responsible and, of course, are the determining voice
27 in policy, but on the operational side they leave that
28 entirely to the bank and the relations with the govern-
29 ment broker are considered -- and are, indeed --
30 operational relations.



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...and we should
...and they would say, "O.K., carry on and let us know what
specific suggestions you have," or alternatively they
might say, "We would rather leave it for a bit and not
deal with it until a bit later." We should then get on
with our internal discussions with the Government and
and make up our minds what sort of financing is the most
appropriate in all the circumstances and then discuss
it further with the Government and eventually, when
we agreed to the general lineup of what we wanted to
do, the Governor of the Bank would have a meeting on
the final day with the Government and, before that
time, we were appropriate and advise the Treasury to that
effect, and the thing would go ahead.

COMMISSIONER LAMM: Is the relationship

with the Government purely advisory between them and
the bank or between them and the Treasury?

LORD CORBETT: Between them and the bank

entirely; it is an operational relationship. The
Treasury don't operate in that. The Treasury are
responsible and, of course, are the determining voice
in policy, but on the operational side they leave that
entirely to the bank and the relationship with the govern-

ment is purely advisory - and that is the position.



1 COMMISSIONER LEMAN: There is a reference
2 in the short statement you gave on this subject before
3 lunch, too, to the fact that the bank had never tried
4 to change or counteract a strong market situation.
5 However, how far short of that has it been the practice
6 in England to try to influence relationships between
7 short rates and long rates, that sort of action, along
8 the whole thing?

9 LORD COBBOLD: The short rates, as I was
10 saying earlier, really are directly governed by bank
11 rates. The Bank of England certainly does have a very
12 definite and conscious effect on short-term rates. On
13 long-term rates I don't really think I can use a better
14 phrase than the phrase I used earlier, to nudge
15 the market in one direction or another. That is to say,
16 in the case of a new issue or in the case of the prices
17 that we are currently fixing for loan sales, we might
18 on certain occasions touch ahead of the market or touch
19 behind the market just to give a slight indication, but
20 we should never, as I say, attempt to counteract or
21 reverse the real market tendency to move the market
22 in one direction or the other, partly because the
23 movement can be so large and one might find one's self
24 merely bolstering and feeding a speculative situation,
25 but also for policy reasons we feel on the whole it is
26 better to let the market broadly find its level.

27 COMMISSIONER LEMAN: Well, there is one more
28 question I would like to ask you on that specific subject,
29 and that is some people have explained to us that they
30 thought there could be some effectiveness from a monetary



...the ...
...the ...
...the ...

...to try to influence relationships between
about rates and long rates, and sort of action along
the whole thing?

JOHN COWDALL: The short rates, as I was
saying earlier, mostly are directly governed by bank
rates. The Bank of England certainly does have a very
definite and considerable effect on short-term rates. On
long-term rates I don't really think I own one a better
phrase than the phrase I used earlier, it might

be marked in one direction or the other. That is to say,
in the case of a new issue or in the case of one put on
that is one currently fixing the term rates, we might
on certain occasions be in a kind of the market or to
behind the market and to give a slight indication, but
it should never, as I say, become so concerned as
reverse the real market tendency to move the market
in one direction or the other. I may remember the
movement can be as large and as high as that and sell
mainly borrowing but through a number of other things,
and also the market tends to move on the whole in its
direction but the market doesn't go the level.

COMMISSIONER BEARD: Well, there is one more
question I don't like to ask you on that special subject,
but as some people have suggested that they



1 policy standpoint in debt management, what they would
2 call countering debt management technique. Could you
3 tell us what your attitude is on this score?

4 LORD COBBOLD: Well, the main answer to that
5 in our case -- and I am purely talking of our case and
6 if I understand correctly what is meant by that -- is
7 that we are always a bit up against it since the war,
8 and as I was explaining earlier, we have maturities
9 every year and we haven't nearly the amount of flexibility
10 that one would like to have and there are many occasions
11 I think when one would like to stand off the market
12 for three years or, alternatively, to try and fund
13 more among short-term debt ahead of time. So far as
14 the United Kingdom is concerned, we have to some extent
15 been the creature of the post-war indebtedness because
16 of very frequent maturities and we haven't had quite
17 the flexibility that would be ideal.

18 COMMISSIONER LEMAN: But assuming that you
19 had the leeway, do you consider that that is an entirely
20 effective tool -- and I am talking of the idea of
21 shortening and lengthening the average debt outstanding
22 as a monetary policy instrument?

23 LORD COBBOLD: I should always have a
24 strong predilection for lengthening in almost all
25 circumstances. I can see the advantage of standing
26 over for a time to allow that to have its effect on
27 supply and demand, I can see the advantage in coming in
28 with a big government issue from time to time, it may
29 have this effect on supply and demand, but in terms of
30 short and long I would always, with a very heavy government



well understood. Well, the main answer to that
 tell us what
 what we are doing.

LODGE: Well, the main answer to that
 is I understand correctly what is meant by that -- is
 that we are always a bit up against it since the war,
 and as I was explaining earlier, we have activities

every year and we have a nearly the amount of flexibility
 that one would like to have and there are many occasions
 I think when one would like to stand off the market
 for three years or, alternatively, to try and run
 down among about seven half ahead of time. So far as
 the United Kingdom is concerned, we have to some extent
 been the victims of the post-war inflation because
 of very frequent inflation and we haven't had quite
 the flexibility that would be ideal.

COMMISSIONER: Now, that means that you
 had the feeling, as you consider that that is an entirely
 effective tool -- and I am talking of the 1955-56
 showing and forecasting the need for this intervention
 as a necessary policy instrument.

LODGE: I should like to have a
 strong recommendation for forecasting in almost all
 circumstances. I can see the advantage of standing
 over for a time to allow that to have its effect on
 supply and demand. I can see the advantage in seeing in
 with a big government from time to time, it may
 have this effect on supply and demand, but in terms of
 and long I would agree, with a very heavy dose



1 debt, be in favour of lengthening wherever I see the
2 possibility.

3 COMMISSIONER LEMAN: Those who believe in
4 this tool believe in it because it can influence
5 liquidity in the economy?

6 LORD COBBOLD: Yes. Well, there again I
7 am afraid I am talking very much from the United Kingdom
8 and our trouble is -- at least all the time I have been
9 concerned with it -- that we have had excess liquidity.

10 COMMISSIONER MACKINTOSH: I have one or
11 two questions, Lord Cobbold, in respect to the effects
12 of monetary policy on the domestic market. In your
13 memo you have quite a strong clear statement to make
14 and agreed with the general line of policy on credit
15 controls and that the inventory policy excluded this
16 in the post-war period. Now, I find that the Radcliffe
17 Committee said almost the same thing but negatively and
18 with a rather more optimistic indication, it seems to
19 me; they said that by their nature monetary measures
20 are incapable by themselves of having an effect
21 sufficiently prompt and far-reaching for their purposes
22 unless applied with a vigour which itself creates a
23 major emergency. Do you think there is a real
24 difference there in your --



...the following is ...

I ... : Yes, ...

on ... I am ... from the United Kingdom and our ... is -- or least all the time I have been concerned with it -- that we have had exact identity.

COMMITTEE ON MONETARY AFFAIRS: I have one or

two questions, ... in regard to the effects of monetary policy on the domestic market. In your memo you have made a strong case ... to make and agree with the general line of policy on credit.

in the past few years. Now, I find that the ... Committee said almost the same thing but negatively and with a rather more ... it seems to me; they said that by their means monetary resources are incapable of themselves of having an effect sufficiently prompt and far-reaching for their purposes unless applied with a vigor which itself creates a major emergency. Do you think there is a real

difference ... in your ...



1 LORD COBBOLD: There is perhaps a difference of
2 emphasis. I would agree -- and perhaps you saw my
3 evidence before the Radcliffe Committee -- that the
4 only time that monetary policy in terms of bank rate
5 or direct credit controls has a strong effect on
6 the economy is when it is applied pretty vigorously,
7 and probably in connection with some other fiscal
8 measures. I think I would still stick to my rather
9 more positive setting out of approximately the same
10 argumentation which as you say the Radcliffe Committee
11 set out, a little more negatively.

12 COMMISSIONER MACKINTOSH: There is
13 a matter which really touches on debt management
14 which bothers me a bit. With a vigorous monetary
15 policy which produces quite sharp changes in rates,
16 do you not, to some extent, destroy government bonds
17 as an investment vehicle?

18 LORD COBBOLD: Well, to me the real
19 factor tending to destroy government bonds as an
20 investment is lack of confidence which has often
21 a greater effect on the long term market. This
22 was, as a matter of fact, one of the particular
23 points on which I personally had a great deal of
24 argument with some members of the Radcliffe Committee --
25 not the committee as a whole. The argument was
26 advanced rather freely in one or two quarters that
27 it would be a good thing to go into the market in
28 a big way to depreciate long term government securities
29 to put the rate up. I have always held that overt
30 and direct action by the authority to depreciate long



... I would agree -- and perhaps you can say
... before the Redcliffe Committee -- that the
only time that monetary policy in terms of bank rate
or direct control has a strong effect on
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and probably in connection with some other fiscal
measures. I think I would still stick to my rather
more positive setting out of approximately the same
argumentation which in you say the Redcliffe Committee
set out, a little more negatively.

COMMISSIONER MACKINNON: There is

a matter which really comes in with management
which perhaps we a bit. With a vigorous monetary
policy which produces quite sharp changes in rates,
do you not, to some extent, thereby government bonds
as an investment vehicle?

LORD CORRIE: Well, to me not really.

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investment is lack of confidence which has often
a greater effect on the long term market. This
was, as a matter of fact, one of the main reasons
points on which I personally had a great deal of
argument with some members of the Redcliffe Committee --
not the committee as a whole. The argument was
advanced rather freely in one or two discussions that
it would be a good thing to go into the market in
a big way to depress the long term government securities
to put the rate up. I have always held that even
and then by the authority to depress the long



1 term government securities in a big way would have
2 that very effect of destroying governmental credit,
3 and the bank has always maintained that that would
4 be a bad thing to do, quite apart from whether it
5 was practical or not, for that very reason.

6 In the short market where the movements
7 of bank rate have an immediate and rather more
8 drastic effect, it does not have that result. That
9 is because short bonds are held by professionals,
10 the discount market and bankers, and they, so to
11 speak, recognize that this is one of the ups and downs
12 and that they are liable to those fluctuations; when
13 it goes one way it will be beneficial, and when it
14 goes the other way they will lose a bit. That is
15 all recognized, and the same consideration does
16 not apply. It does apply very much in the
17 long term market, but, I repeat, the general confidence
18 and the feeling that someone is doing something about
19 it is more important than the actual movements of
20 rate there.

21 I, for one, would always set my face
22 against the authorities deliberately reducing the
23 value of long term government securities by large
24 amounts because they are held by the general public,
25 and I believe that would have a very deleterious
26 effect on the government credit.

27 COMMISSIONER MACKINTOSH: Do you feel
28 the current techniques of monetary control, as we
29 know them, are adequate?

30 LORD COBBOLD: Well, I think one should



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that very effect of destroying governmental credit.

...had thing to do, date spring from whether it
was practical or not, for that very reason.

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of bank rate have an immediate and rather more
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against the authorities deliberately reducing the
value of long term government securities by large
amounts because they are held by the general public,
and I believe that would have a very deleterious
effect on the government's credit.

COMMISSIONER WALKINSHAW: Do you feel
the current securities of monetary position, as we
LORD CORFORD: Well, I think one should



1 always be open to new ideas and new thoughts. We
2 introduced the special deposit arrangement quite recently,
3 as you know, and I should say we have made quite
4 a number of refinements without any startling
5 changes over the past twelve years. Indeed,
6 in the handling of the debt management side it is
7 probably new to go as far as nudging it in one
8 direction or the other. That, I think, was not
9 done before recent years. We have been a little
10 more positive on that.

11 COMMISSIONER MACKINTOSH: Previously
12 it would be largely a bills only policy?

13 LORD COBBOLD: Yes, almost entirely.
14 As I say, on the question of near banks I think we
15 are very far from the end of the story there, and
16 I would have thought that that was the direction
17 in which changes or refinements over the next period
18 would probably be necessary.

19 COMMISSIONER MACKINTOSH: Do you think
20 a policy of freezing advances is an effective way,
21 or that it should not be used except in fairly extreme
22 circumstances?

23 LORD COBBOLD: I dislike freezing
24 except in extreme circumstances. I think that
25 whatever means are used there is probably an advantage
26 in damping down a bit when you see things going up
27 too fast, and I would imagine, whichever particular
28 technique is used, central bankers would still think
29 it wise to use some dampening effect if they saw
30 bank advances going upwards too fast. I think the



of retirement within, say, five years.
I mean the past twelve years, indeed.
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direction or the other. That, I think, was not
done before recent years. We have been a little
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it would be largely a better only policy?
NONE WOULD: Yes, almost entirely.
As I say, on the question of investments I think we
are very far from the end of the story there, and
I would have thought that that was the direction
in which changes or retirement over the next period
would probably be necessary.

COMMISSIONER WASHINGTON: Do you think
a policy of freezing advances in an old way
or that it should not be used except in fairly extreme
circumstances?

LOD CORBIN: I think freezing
except in extreme circumstances. I think that
whatever means are used there is probably an advantage
in bringing down a bit when you are looking at
too fast, and I would imagine, whatever percentage
percentage is used, would be a good thing to do
to get some dampening effect if they can
be used. I think the



1 question of pace is far more important than the question
2 of volume there.

3 COMMISSIONER MACKINTOSH: Freezing, to
4 use that word again, is more or less carried out
5 by agreement with the banks?

6 LORD COBBOLD: Yes. Of course, we have
7 a great complication there in that we use almost
8 entirely an overdraft system. People have limits
9 to their overdrafts, and these overdraft limits,
10 taking a very broad average, are used to the extent
11 of about 60 per cent, or perhaps a little bit more,
12 so there is always a margin of somewhere between
13 30 per cent and 40 per cent of the limits that
14 customers can draw on. This means that for six
15 months or twelve months the banks can do nothing
16 about it, and that has added considerably to the
17 difficulty of making changes in monetary policy and
18 in making our requests to banks to limit advances
19 effective quickly.

20 There is no doubt from that point of
21 view that the system of fixed bank loans makes it
22 easier for the policy to have an immediate effect,
23 because where a limit has been given that limit
24 is normally good for six months or good for twelve
25 months, and there is very little that the bank lenders
26 can do about it until the expiry of that period.
27 I think that has certainly been, I think you could
28 call it, a weakness in the system.

29 COMMISSIONER MACKINTOSH: Another weakness
30 that you imply is the lag in effect. I think you say



COMMISSIONER MARSHALL: Presiding, to
the word "margin" is more or less carried out
to the margin of the bank.
LORD ROSS: Yes. Of course, we have
a great complication there in that we use almost
entirely an automatic system. People have limits
to their overdrafts, and these overdraft limits,
taking a very broad average, are used as the extent
of about 50 per cent, or perhaps a little bit more,
so there is always a margin of somewhat between
30 per cent and 40 per cent of the limit that
customers can draw on. That means that for six
months or twelve months the limits can do nothing
about it, and then has to be completely to the
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in making our requests to banks for limit advances
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I think that has certainly been, I think you could
call it, a weakness in the system.
COMMISSIONER MARSHALL: Another weakness
is the lag in effect. I think you say



1 at some place that it may take some six months before
2 there is a --

3 LORD COBBOLD: That has been our general
4 experience. People have commitments and arrangements,
5 and it does not make any sense for a banker to go to
6 his big industrial customer and say: "Well, you have
7 got to reduce your bank borrowing by 25 per cent
8 by next week". That would mean either throwing
9 stocks onto the market in a ridiculous way, or
10 interrupting some development scheme that was three-
11 quarters of the way through. It does take a certain
12 amount of time. I do not say that in a moment of
13 absolute crisis you could not bring it about more
14 quickly than that, because you could, but that would
15 be at the expense of doing quite a bit of damage
16 to the system.

17 COMMISSIONER MACKINTOSH: Again,
18 borrowing is like the bill portfolio. Somebody's
19 loan is always there. The credit term is always
20 coming up for consideration.

21 LORD COBBOLD: As I say, there are
22 always programmes half way through, and there is
23 the level of stocks people keep over that period
24 of the year. A violent change brought about by
25 some monetary direction can often do a good deal
26 of harm. As I say, I do not think it can always
27 be avoided, and there are occasions when you have
28 to force it. For instance, in September, 1957 --
29 I think that is the correct date -- when we jumped
30 from 5 to 7 per cent and had a rather major crisis,



as some place that is not some one month's notice
there is a --

LORD CORBETT: That has been our general

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I think that in the current date -- when we passed
from 5 to 7 per cent and had a rather major crisis.



1 it acted rather more quickly but it probably created
2 a good deal of confusion in the process. Making
3 these drastic changes is not a thing that one likes
4 to do frequently.

5 COMMISSIONER MACKINTOSH: It is relatively
6 easy to see what you might call the financial results
7 of monetary policy and some of the effects on
8 international positions, but any inquiries that have
9 been made into the effect on the amount of real
10 investment seem to me always to be disappointing.
11 It is very hard to fix on results. Have you reached
12 any conclusions on this?

13 LORD COBBOLD: I would agree that that
14 is very difficult, indeed. After all, what the
15 businessman, whether he is expanding or buying more
16 stock, is thinking about is what the general position
17 is going to be in three months, six months, or twelve
18 months, and he is probably more bothered about that
19 than about particular credit actions which the
20 central bank may be taking at a specific moment.
21 Therefore, what he is really interested in, I think,
22 is seeing whether the actions taken by the authorities
23 are such as to promote activity in the forthcoming
24 period, and he is looking at things much more generally
25 than at a specific change in rates.

26 I would make one observation which may
27 be relevant to that. Broadly speaking, I think it
28 is true, in the ten or twelve years after the war
29 there was such a pressure towards expansion generally,
30 and such inflationary pressures generally, that unless



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be relevant to that. Broadly speaking, I think it
is true, in the case of twelve years after the war
that you have a general expansion period.



1 there were very heavy movements the big business people
2 were not tremendously concerned about changes in interest
3 rates. I think everybody becomes concerned when
4 they go above a certain level. I mean, a 7 per
5 cent bank rate in England certainly has an effect,
6 I would say, on the big industrial developers, but
7 a change from $4\frac{1}{2}$ to 5 per cent, or even from $4\frac{1}{2}$ to
8 $5\frac{1}{2}$ per cent in those years of expansion had a rather
9 limited effect.

10 On the other hand, if you get to a general
11 economic situation where profits are being squeezed
12 a bit, where turnover may be on the up but profit
13 is more difficult, which I think has been the more
14 recent situation, I think this then becomes much
15 more of a factor. I would risk an opinion that in
16 the past two or three years people have looked much
17 more at their borrowing charges than they did in the
18 preceding twelve years. I think people, on the
19 whole, have been fairly conscious of borrowing charges --
20 again, I am talking about the United Kingdom -- in
21 the last two or three years when it has become more
22 difficult to make profit.

23 COMMISSIONER MACKINTOSH: As I think you
24 found in England, and certainly on this continent,
25 it proved fairly hard to get businessmen to say how
26 they have been affected by interest rates. Perhaps
27 they do not know, but one does not like to be forced
28 into the position where one accepts that actions are
29 the same at high rates as at low rates.
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into the position where one accepts that conditions are
the same at high rates as at low rates.



1 LORD COBBOLD: Yes. As I say, if profits
2 are easy and everything is on the up and up, then I
3 think it is possible that the level of rates does
4 not have a tremendous influence until it gets very
5 high. When interest rates get very high they
6 inevitably have an influence. In another period
7 when profitability is less easy interest rates come
8 to have a definite effect, and people look at them
9 very much more.

10 COMMISSIONER GIBSON: Perhaps I may ask
11 another question along these lines. When the Bank
12 of England changes its policy by announcing a change
13 in the bank rate -- a sizeable upward change in the
14 bank rate -- would you say that this induces changed
15 expectations in the business community which in turn
16 may be the reason for the change in the demand for
17 money rather than an actual change in the cost of
18 money induced by the change in the bank rate?

19 LORD COBBOLD: The bank rate has a
20 very strong traditional -- or whatever you like to
21 call it -- it has still a strong effect in England.
22 I do not know whether it has here. It is one of
23 the things that get headlines in the evening news-
24 papers, if I may put it like that. A sharp upward
25 change in the bank rate does bring home to the public,
26 I think, more than any other form of official state-
27 ment or exercise that there are dangerous waters ahead.

28 COMMISSIONER GIBSON: And by "public"
29 you mean the business community?

30 LORD COBBOLD: The very wide general public.



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COMMISSIONER GIBSON: Perhaps I may ask

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COMMISSIONER GIBSON: And "pulls"

you mean the business community?

LORD CORBOLD: The very wide general public.



1 It is a curious thing, but that is how it is. You can
2 go out and make statements about the difficult
3 situation that is facing us, and all that sort of
4 thing, and everybody is inclined to shrug that off
5 a little bit and to say: "We have heard that before",
6 but if you put up the bank rate from 4 per cent to
7 5 per cent then that has an immediate effect on a wide
8 section of the community. I am not saying that that
9 makes any particular sense, or whether it is a good
10 or a bad thing, but that is a fact in my country.

11 COMMISSIONER GIBSON: And, therefore,
12 the effect of an upward change in the bank rate on
13 expectations would be more important in causing people
14 to reduce their expenditures rather than the actual
15 increase in the cost of money?

16 LORD COBBOLD: I think that that is so.

17 COMMISSIONER GIBSON: Do you think that
18 that kind of thinking applies on the downgrade, to
19 a reduction in the bank rate?

20 LORD COBBOLD: I would think so. I
21 would have to digress a little from that. Whenever
22 we have had to put the bank rate up one of the
23 things I have always said to myself is: "How are
24 we going to get it down without appearing to relax
25 too quickly?". Obviously, you do not want to live
26 with a 7 per cent bank rate for a long time. I do
27 not think anybody will dispute that. Therefore,
28 when you go up to 7 per cent, one of the things you
29 have to ask yourself is: "How on earth am I going to
30 get away from this without giving an undue impression



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1 that everything is now easy?", and one of our difficulties
2 has been to put that across. We try to come down,
3 as you know, gradually rather than with a bump, and
4 while doing so make loud noises to the effect that
5 while things are not in a state of crisis any more,
6 please do not think that everything is now easy. We
7 have not always been wholly successful in getting that
8 across. It certainly does affect public judgment
9 both ways.

10 COMMISSIONER GIBSON: Also with respect
11 to this question of how monetary policy works, some
12 students of this matter say that it is more the avail-
13 ability of money than it is the price of money that is
14 important when money is getting tighter or easier.
15 Would you care to make any comments on that?

16 LORD COBBOLD: I would go back to what
17 I was saying to Mr. Mackintosh. In times of boom,
18 I think, that is certainly true, when profits look easy.
19 I would say that during the ten years after the war
20 it was availability that probably bothered people more
21 than price. I think as soon as you get into a more
22 difficult profit situation then the cost of money
23 becomes very much more a consideration.



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1 I would always think that when you get to high levels --
2 for example, the 7 per cent bank rate in the U.K. --
3 that is a very considerable consideration in pure cost.
4 But if you are talking of a difference between a $4\frac{1}{2}$
5 per cent and a 5 per cent bank rate and a corresponding
6 difference in the availability, on the whole I would
7 say that in a time of great prosperity and rather
8 inflationary pressures that margin of availability
9 is more important than that margin of interest rate
10 cost.

11 COMMISSIONER GIBSON: So that availability in
12 the United Kingdom is not by any means fully reflected
13 in changed costs or interest charges?

14 LORD COBBOLD: No, not always. Through
15 that period, in a way, we have been just as much
16 concerned to ask the banks to go steady in their
17 lending policy, to introduce a special deposits
18 mechanism to reduce the availability, as we have to
19 put up the cost of it. We have tried to do the
20 two together, to a certain extent.

21 COMMISSIONER GIBSON: You have never had
22 any legal ceilings on interest rates, or that sort
23 of thing?

24 LORD COBBOLD: No.

25 COMMISSIONER GIBSON: But, in fact, the
26 interest rates structure has not gone up as it would
27 have gone up in a purely competitive market in tight
28 money periods?

29 LORD COBBOLD: Probably not, no, that is
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LORD GOBOLD: Probably not, no, that is



probably true.

COMMISSIONER GIBSON: Would you care to say anything about how tight money affects consumer decisions in addition to business decisions? Is this an important factor, do you think?

LORD COBBOLD: It is a very important factor. I should have thought the sort of considerations were normally the same. That is to say, I would think that the bank rate as a warning bell affects consumer decisions quite considerably.

COMMISSIONER GIBSON: These are decisions to buy automobiles, houses and that sort of thing?

LORD COBBOLD: Yes. If I may repeat myself, I am not saying whether it is right or wrong, or sensible or not sensible, but there is no doubt with the British public that a certain sharp rise in the bank rate does more than a great number of speeches by a great number of people, to have an effect on the public mentality that things are rather difficult and that they had probably better go a bit slow in their spending. That is a traditional fact, and it seems to have that effect. Perhaps it is more psychological than real, in some ways. If I may put that a little more pictorially, so to speak, if you went either to a rather superior business dinner party in Birmingham or if you went in the evening around to a public house on the outskirts of any town in England, people would know that the bank rate had been put up that day, and would be interested in it, and that would be a subject of general conversation; and the chap either at the



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1 business dinner or around at the public house, would say
2 "Oh, things are obviously a bit tricky".

3 COMMISSIONER GIBSON: They would be
4 thinking of it in terms of their spending and savings?

5 LORD COBBOLD: They would be wondering
6 how that is going to affect them.

7 COMMISSIONER GIBSON: So that
8 psychologically this is very important, in addition
9 to the actual impact on the financial world.

10 LORD COBBOLD: Psychologically I would
11 maintain this remains particularly important, especially
12 in the case of a large and rather dramatic move.

13 COMMISSIONER GIBSON: Do you like this
14 system where you have, as a matter of custom, the
15 lending rates and deposit rates of the clearing banks
16 almost associated with the bank rate?

17 LORD COBBOLD: We find it very convenient,
18 because it means we have been able to operate on the
19 cost of lending quite directly. It suits us.

20 COMMISSIONER GIBSON: Does it fit into
21 other kinds of rates that affect spending generally?

22 LORD COBBOLD: Building deposit
23 and hire-purchase charges, et cetera, do not necessarily
24 follow a movement of a quarter or half immediately,
25 but if the bank rate and, consequently, banks' lending
26 rates are moving up considerably, surely other rates
27 will move up competitively with them.

28 COMMISSIONER GIBSON: This extends out
29 to the medium and longer rates to a considerable
30 degree?



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1 LORD COBBOLD: To some extent. You
2 often get, as I said earlier, the confidence factor
3 working rather the other way in longer rates, because
4 if long-term government securities have been sagging
5 because there has been a crisis looming and you have
6 not been doing anything about it, if you then do
7 something about it, that will have an effect on the
8 long-term securities.

9 COMMISSIONER GIBSON: When you mentioned
10 building rates you were thinking of deposit or lending
11 rates?

12 LORD COBBOLD: I was thinking of their
13 deposit rates, primarily.

14 COMMISSIONER BROWN: In relation to the
15 bank rate, the lending rate of the banks, you mentioned
16 this morning a margin of 1 to $1\frac{1}{2}$ per cent. This is
17 the widest range?

18 LORD COBBOLD: No.

19 COMMISSIONER BROWN: Is one per cent the
20 prime rate?

21 LORD COBBOLD: I think there are some
22 people who are probably borrowing at a bank rate plus
23 half, a bank rate plus one, which is a normally
24 good rate, and it may go up to bank rate plus 2 or $2\frac{1}{2}$,
25 even. That is the sort of spread.

26 COMMISSIONER BROWN: Do the banks find
27 this system assists in rationing credit?

28 LORD COBBOLD: No, I would not say that
29 assists in rationing credit. That is a question of
30 credit-worthiness -- that is, the rate.



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1 COMMISSIONER BROWN: But the banks are
2 still faced with the problem of rationing credit
3 among established borrowers?

4 LORD COBBOLD: The banks have been faced
5 with that, quite definitely, in meeting the official
6 requests to limit their advances or damp them down.
7 It faces them with a very difficult problem of
8 rationing.

9 COMMISSIONER BROWN: They cannot do this
10 just by increasing rates?

11 LORD COBBOLD: No. On occasion we
12 have given some official indication, for example,
13 that we should like to see agricultural finance
14 and export finance maintained, but we would like to
15 see them go slow on hire-purchase and commercial
16 building, and one or two of those general indications.
17 We have tried to avoid that as much as possible.

18 COMMISSIONER BROWN: Have you made
19 such suggestions as far as rates are concerned?

20 LORD COBBOLD: No, never. You mean
21 charged more to one group, or less?

22 COMMISSIONER BROWN: Yes.

23 LORD COBBOLD: Never.

24 COMMISSIONER BROWN: It is on a direct
25 rationing basis?

26 LORD COBBOLD: Yes, rationing in the
27 sense of the sort of speeches the Bank of England
28 have made from time to time -- "We hope you will
29 damp your advances down, but we hope that in that
30 process you will pay due attention to the needs of



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LORD CORBOLD: The banks have been faced
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COMMISSIONER BROWN: But the banks are



1 export and agriculture, and will tend to damp down a
2 bit more on certain other things."

3 COMMISSIONER BROWN: This relationship
4 between the bank rate and the lending rate has been
5 an old-established custom, and there is no statutory
6 authority for it?

7 LORD COBBOLD: None at all.

8 COMMISSIONER BROWN: Can you see any
9 reason against having statutory authority for it?

10 LORD COBBOLD: I see no necessity for
11 it with us. It is a universal custom -- universal
12 in the U.K., I mean.

13 COMMISSIONER BROWN: There are two
14 other matters I would like to ask about in a little
15 more detail. Dr. Mackintosh has dealt with the
16 point you made, "that it takes some six months before
17 a switch from easy to tight conditions works" --
18 and your phrase is -- "right through the system".
19 Does this refer to the banking system or the financial
20 system or the whole country?

21 LORD COBBOLD: The whole country.

22 COMMISSIONER BROWN: That is, the
23 effect is fairly rapid throughout the whole country?

24 LORD COBBOLD: The effect is fairly
25 rapid on the discount market and the short money
26 apparatus generally. In fact, the effect is felt
27 on the next day. The effect is probably felt by
28 the banking machinery within three or four weeks.
29 I was speaking of the time that it takes to get through
30 to effect other expenditure decisions and consumer

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1 decisions.

2 COMMISSIONER BROWN: One further question
3 on techniques. When the government broker starts
4 to act in the market on one side or the other, in
5 accordance with your wishes, does he take positive
6 action, or is it rather a matter of responding --

7 LORD COBBOLD: Both. There again,
8 I repeat that we never try and go against a trend,
9 but he will be taking positive action in one or
10 two fields, and positive action in buying for us
11 the next maturing issue. He is always on the lookout
12 for the early maturing issues to help us with a
13 conversion process. In a sense he will be taking
14 positive action on the recent new issues of which
15 the issue department has a large holding, in that
16 he will be seeking opportunities to place that on
17 the market as opportunities occur. You could
18 call that passive action in the sense that he
19 will not push that unless there is a demand, but
20 at the same time he has a positive instruction
21 to get ahead with that as market possibilities
22 allow.

23 Another function I did not mention
24 is that we try not to let any one stock get out of
25 line with the general run of stocks because of a
26 particular demand or a particular offer of that
27 particular stock, so that we normally keep in the
28 Bank of England issue department quite a big holding
29 of a whole range of government stocks. If one
30 stock for particular reasons -- somebody realizing



on technicalities. When the Government proposes to act in the market on one side or the other, in accordance with the principle of responding -- action, or as it happens a matter of responding -- I repeat that we never try and go against a trend, but we will be taking positive action in one or two fields, and positive action in buying for us the next maturing issue. He is always on the lookout for the early maturing issues to help us with a conversion process. In a sense he will be taking positive action on the present new issues of which the issue department has a large holding, in that he will be seeking opportunities to place them in the market as opportunities occur. You could call that passive action in the sense that he will not push that unless there is a demand, but at the same time he has a positive instruction to get ahead with that as market possibilities allow.

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1 for an estate duty, or something of that sort --
2 appeared to be going out of line, the government
3 broker would be prepared to take that stock in against
4 other comparable stocks so as to even out the process.

5 COMMISSIONER BROWN: In other words,
6 you are operating a yield curve?

7 LORD COBBOLD: Yes, that would be a
8 passive function, I think really. That is a purely
9 technical market equalization function.

10 COMMISSIONER BROWN: This is a rather
11 technical point too: does he operate always through
12 jobbers?

13 LORD COBBOLD: Yes.

14 COMMISSIONER GIBSON: I have one other
15 question in this area. Lord Cobbold, you have
16 spoken at some length, from time to time, about the
17 relations between the Bank of England and the clearing
18 banks, and about the informal arrangements that are
19 made. I believe this process is called "moral
20 suasion"?

21 LORD COBBOLD: Yes, that is one description
22 of it.

23 COMMISSIONER GIBSON: There is a lot of
24 this, I take it, in the U.K. system. Do the banks
25 show any less willingness to co-operate the more
26 frequently they are asked to take special measures
27 to tighten up a little here and put a little more
28 there?

29 LORD COBBOLD: I think they complain a bit
30 more, but they play along just the same -- up to date,



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1 COMMISSIONER GIBSON: You did hint at this
2 earlier: at times I think you do have a bit of
3 difficulty in undoing a bit of moral suasion.
4 You have asked people to ease up here a little
5 and then have told them not to ease up.

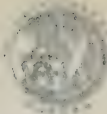
6 LORD COBBOLD: Undoing moral suasion is not
7 nearly the same difficulty, because it does not get
8 public publicity. The difficulty is undoing the high
9 bank rate, really. If the governor says to the
10 chairman of the clearing banks, "Well, things are a
11 bit easier and you need not bother quite as much as
12 I asked you two or three months ago", that may get
13 diffused a bit, but it does not get the headlines
14 that everything is now easy. Whereas if you were to
15 bring the bank rate down from six to five, that is
16 an immediate general talking point and it has a
17 psychological effect that the crisis is now over and
18 everything is plain sailing.

19 COMMISSIONER GIBSON: But suasion does enter
20 into it?

21 LORD COBBOLD: That comes under the first
22 category, and that can be done much more gently and
23 gradually.

24 COMMISSIONER GIBSON: Even though everybody
25 knows about it?

26 LORD COBBOLD: Even though everybody knows
27 about it, it is not a thing that goes to the public.
28 That is a thing that would be known about in rather
29 limited financial circles, those that would be
30 interested in it. Again, in press terms, that would
be on the financial pages and not on the front page.



COMMISSIONER GIBSON: You did hint at this
earlier; at times I think you do have a bit of
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1 COMMISSIONER GIBSON: You are quite happy
2 about this method of working with the bank system?

3 LORD COBBOLD: I can only say it has worked
4 extraordinarily well in the time I have had to cope
5 with it.

6 COMMISSIONER BROWN: May I ask one more
7 question which is along this line, but slightly off-
8 centre? In Canada some of the provincial governments
9 in recent months and years have been issuing what
10 are referred to as parity bonds which are, in effect,
11 short-term and call paper. I have a clipping from the
12 London Financial Times saying that you have a somewhat
13 similar problem in England with respect to the short-
14 term borrowing of local governments, which is now up
15 in excess of £ 1,000 million, and this is apparently
16 connected with and is creating some problems in
17 connection with the control of short-term money markets.
18 Would you care to comment on this, or are there problems
19 involved, or have you any suggestions as to how it might
20 be dealt with?

21 LORD COBBOLD: I think that has perhaps
22 arisen a bit more since my time, but it is certainly
23 true that local authority short-term borrowing was
24 going up, I think, rather more than we thought entirely
25 convenient, and we had some fears it might lead to
26 problems later on. Local authorities were taking a
27 great number of short-term deposits at one time. I
28 could not really comment on developments in that in the
29 last 12 months, I am afraid.

30 THE CHAIRMAN: You have, or you did have at



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great number of short-term deposits at one time. I

could not really comment on developments in that in the

last 12 months, I am afraid.

THE CHAIRMAN: You have, or you did have an



1 one time, what is known as a capital issues committee.
2 Is that still in existence?

3 LORD COBBOLD: I cannot remember whether
4 it is statutorily in existence but it is now out of
5 action. I think it still statutorily exists.

6 THE CHAIRMAN: What was the purpose of that?

7 LORD COBBOLD: That was definitely rationing
8 long-term issues. You could not make an issue on the
9 long-term market, or on the London market generally,
10 without the permission of the capital issues committee.

11 THE CHAIRMAN: So it was, in effect, an
12 instrument of monetary policy to that extent?

13 LORD COBBOLD: Yes, in wide terms.

14 THE CHAIRMAN: But you found it was
15 unnecessary?

16 LORD COBBOLD: To some extent it became
17 extremely difficult in post-war conditions. It was,
18 in my own judgment, very necessary in wartime conditions
19 and shortly after the war. As things were freed up
20 generally and controls were removed generally, I think
21 it became increasingly difficult to maintain a financial
22 control when the rationing controls had disappeared.

23 THE CHAIRMAN: You do not regard it as being
24 a suitable control under ordinary conditions?

25 LORD COBBOLD: Not really. It became, I
26 think --

27 THE CHAIRMAN: Under peacetime conditions?

28 LORD COBBOLD: -- under peacetime and free
29 conditions it really became too easy -- I do not mean
30 by illegitimate means, but by legitimate means to get



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by illegitimate means, but by legitimate means to get



1 around it. If they turned you down you could get
2 around it by borrowing outside the country or by
3 borrowing short and having it converted to long later.
4 We found it was the sort of control that runs you
5 into a lot of trouble and a great deal of rather
6 well-justified criticism, and we felt it was not
7 giving results towards the end of its existence.

8 THE CHAIRMAN: There was a suggestion made
9 in one brief that we have seen that that sort of thing
10 might be useful.

11 LORD COBBOLD: I think it was useful earlier
12 on, in the immediate post-war stages.

13 COMMISSIONER MACKINTOSH: It is awfully hard
14 to establish any reasonable priorities.

15 LORD COBBOLD: It is very difficult unless
16 you have physical controls at the same time.

17 THE CHAIRMAN: We move then to number 5,
18 which is also the last item: responsiveness of
19 foreign exchange markets to domestic monetary policy;
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1 LORD COEBOLD: I think, sir, we have perhaps
2 verged on that once or twice in what we have been saying
3 already, but I would like to make a few more specific
4 points.

5 Inter-relation between developments in
6 the international field and domestic monetary
7 policy has increased steadily during the past 15 years,
8 with the gradual return, after wartime conditions, to
9 free exchanges. During these 15 years the Bank of
10 England has probably, of all the major central banks,
11 had to concern itself more with the international
12 field because throughout these years balance of payments
13 and foreign exchange troubles have only been just around
14 the corner, and also because sterling has been and is
15 a very important reserve currency. Canada also clearly
16 has a special position in this matter because of the
17 very close contact with the American market and the
18 American rate structure. But, I would say, generally,
19 with the present degree of freedom in trade and money,
20 no central bank can afford to take decisions for
21 domestic reasons only, without any regard to inter-
22 national developments, and any decisions so taken are
23 inevitably harmful to the international currency
24 structure which has been laboriously built up since
25 the war.

26 One can, I think, to some extent divide
27 the effect of domestic monetary policy on the foreign
28 exchange market into two categories, though those
29 categories overlap one the other. There is the general
30 confidence side and there is the technical side of



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1 movements of short-term money, and so on, in one direction
2 and another. Our experience has been that at the times
3 when a foreign exchange crisis has been looming, strong
4 monetary action, if it is taken, as it several times
5 has been along with other decisions in the fiscal field,
6 has had a very considerable effect on our balance of
7 payments. But, I would underline that it is always
8 confidence, that is to say, the general attitude of
9 overseas markets, overseas bankers and the public over-
10 seas generally about the general policy of the United
11 Kingdom, which is the determining and over-riding
12 factor.

13 I would not say that you can always be
14 certain that a tight monetary policy will react quickly
15 on the foreign exchange position. I would, however,
16 with considerable certainty put the converse of that,
17 that if any authority in a major centre runs a very easy
18 money policy which is much easier than the other major
19 centres are running, for any considerable time, that
20 will certainly have an adverse effect on its foreign
21 exchange position. I think that is quite certainly
22 true.

23 The confidence factor to which I referred
24 is, I think, particularly true of sterling partly
25 because of the very heavy overseas sterling liabilities
26 which we inherited from the war and partly because
27 sterling with the United States dollar and gold
28 traditionally, and practically today, constitutes one
29 of the main reserve currencies.

30 I said there was a confidence factor and a



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I said there was a confidence factor and



1 technical factor. I have dealt with the confidence
2 factor. Then, there are the technical sides; that is
3 to say, the attraction of floating short-term money
4 to the centre which offers higher interest rates.
5 I said earlier these two factors overlap because
6 international short-term money will not move into a
7 centre which offers better interest rates unless people
8 have confidence that that particular centre is going to
9 be able to hold its position and hold its rate; so that,
10 the two interlock. But the technical factors, by and
11 large, I mean mainly the movement of short-term money
12 which is looking for the best remuneration it can find,
13 is helpful often on a very, very short view to re-establish
14 a position, and there have been times in the recent
15 history of the U.K. and sterling where we have put up
16 interest rates sharply, put them above the rates in
17 other centres, with the deliberate intention of
18 attracting some short-term money back which may have
19 left earlier on, and so re-establishing confidence
20 and keeping our reserves at a reasonable level.

21 On the other hand, those movements of
22 short-term money can become embarrassing and, as in
23 so many instances in monetary policy, one has to weigh
24 advantage against disadvantage. If you have a large
25 volume of short-term money coming in it adds to
26 confidence and it makes your reserves look better.
27 On the other hand, it means a country is nationally
28 bearing a fairly high interest cost and paying that
29 overseas; and also your position is being made to look
30 a good deal better than it is, and the build-up of your



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1 reserves by the inflow of what is purely short-term and
2 very volatile money may conceal there are still
3 fundamental things which ought to be dealt with in
4 the economy and may give a misleading impression of
5 good health. That is a point which always has to be
6 watched.

7 In brackets, there is a double prong to
8 that because not only when your rates are higher than
9 neighbouring centres, or other important centres,
10 do you attract short-term
11 deposit money, but you push away borrowing; that is
12 to say, in a centre like London where a great deal of
13 international borrowing is done all the time, if
14 borrowing is relatively at one time cheaper in London
15 than in Paris or New York or Amsterdam, then a lot of
16 international borrowing will be done in London. The
17 moment you put the rates up in London, that will switch
18 a great deal of that borrowing to Amsterdam, New York
19 or Paris.

20 The advances and lending side is not quite
21 as important as what is normally known as hot money,
22 the movement of deposits, but it is very important
23 and we have found that moves very quickly. There are
24 these days a great number of very large international
25 corporations who rightly and properly -- it is their
26 business -- look around the markets every day to see
27 where borrowing is cheapest and where deposits get the
28 best remuneration, and there is a lot both of short-term
29 borrowing and deposit which flows around in that way,
30 and in certain circumstances can conceal an unsatisfactory



... by the influx of what is purely short-term and

very volatile money may conceal there are still

the economy and may give a misleading impression of
Good health. That is a point which always has to be
watched.

In practice, there is a double wrong to
that because not only when your rates are higher than
neighbouring centres, or other important centres,
do you attract short-term

deposit money, but you push away borrowing; that is
to say, in a centre like London where a great deal of
international borrowing is done all the time, if
borrowing is relatively at one time cheaper in London
than in Paris or New York or Amsterdam, then a lot of
international borrowing will be done in London. The
moment you put the rates up in London, that will switch
a great deal of that borrowing to Amsterdam, New York
or Paris.

The advances and lending side is not quite
as important as what is normally known as hot money,
the movement of deposits, but it is very important
and we have found that moves very quickly. There are
these days a great number of very large international
corporations who rightly and properly -- it is their
business -- look around the markets every day to see
where borrowing is cheapest and where deposits get the
best remuneration, and there is a lot both of short-term
borrowing and deposit which flows around in that way,
and in certain circumstances can conceal an unbalanced



1 position.

2 I am not trying to draw any definite
3 conclusion from that, but I am saying that is an
4 extremely important factor which we have watched with
5 very great care in past years.

6 On the general relationship of internal
7 monetary policy with its external effects, I was very
8 much struck in the 10 years following the war most
9 particularly between the attitude in the United Kingdom
10 and in the United States, and I think perhaps for many
11 of those years the Canadian attitude was more like
12 that of the United States than the United Kingdom.
13 Since the end of the war, of course, for very obvious
14 reasons the United Kingdom has always been concerned
15 with this overseas aspect. We have had very heavy
16 overseas liabilities. We have been in a sense living
17 on a shoestring in terms of foreign exchange. We have
18 been trying to get our exchange controls freed up
19 gradually and get rid of the controls of wartime, but
20 we have had to move slowly and carefully, and we have
21 throughout been extremely conscious of the effect on
22 the foreign exchanges and the effect on overseas
23 opinion about sterling. In my annual visits to the
24 United States, in the first 10 years after the war,
25 I always used to compare notes with my banking friends
26 in the United States and, of course, this question
27 did not occur to them at all, and they were thinking
28 of internal monetary policy during those years entirely
29 in terms of internal boom, internal slump, employment
30 and all the internal things. It is only in recent



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On the general relationship of internal monetary policy with its external effects, I was very much struck in the 10 years following the war, particularly between the attitude in the United Kingdom and in the United States, and I think perhaps for many of those years the Canadian attitude was more like that of the United States than the United Kingdom.

Since the end of the war, of course, for very obvious reasons the United Kingdom has always been concerned with this overseas aspect. We have had very heavy overseas liabilities. We have been in a sense living on a shoestring in terms of foreign exchange. We have been trying to get our exchange controls lined up gradually and get rid of the controls of wartime, and we have had to move slowly and carefully, and we have throughout been extremely conscious of the effect on the foreign exchanges and the effect on overseas opinion about sterling. In my annual visits to the United States, in the last 10 years after the war, I always used to compare notes with my banking friends in the United States and, of course, talk a good deal about them as well, and they were thinking of internal monetary policy during those years entirely in terms of internal boom, internal slump, expansion and all the internal things. It is only in recent



1 years -- the past five or six years -- that they have
2 related the internal policy questions to the questions
3 of balance of payments and foreign exchange. I always
4 used to say to Mr. Martin and my other American friends
5 that while I should be very happy to be in their
6 position and not to have to worry about foreign exchange
7 reserves, as they did not in those years, there were
8 at the same time some disadvantages because the fact
9 we have been so near to exchange difficulties, and
10 that everybody is very conscious of the level of
11 reserves, does act as a very quick warning bell on
12 internal policy and internal conditions. That is to
13 say, that in the United Kingdom we have just not been
14 able to allow ourselves the luxury of getting into any
15 considerable trouble on the monetary or fiscal side,
16 because we should have immediately had pretty violent
17 exchange troubles. On the occasions when we have not
18 dealt quickly enough with a developing situation we
19 have very quickly met with exchange difficulties of
20 that sort, whereas, as Mr. Martin and I used to agree,
21 in the early days after the war it was very much more
22 difficult for the Federal Reserve authorities to
23 encourage restraint and to point to things that ought
24 to be done because they had not got this warning bell
25 on foreign exchange difficulties ringing very loud
26 in the ears of the public.

27 However, that is going back a little on
28 earlier history, and in the last few years that has
29 changed, and I think you would find -- in fact, I am
30 sure we should all find very general recognition around

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1 the world that internal monetary policy and the
2 movements on the foreign exchanges and balance of
3 payments are very closely interlocked.

4 I might perhaps, to end my statement on
5 this section, just allude to the very great importance
6 which I have always attached to central banking
7 co-operation. This has a long history. We at the
8 Bank of England have been fortunate enough to have
9 extremely close contacts with the individual central
10 banks throughout the Commonwealth, with the Federal
11 Reserve system in America, and with the European
12 central banks, and it has undoubtedly been of the greatest
13 assistance both in the formation of policy and in the
14 execution of operations. It is, of course, possible
15 to maintain a degree of contact between central banks
16 all the time, which is more difficult, I think, in
17 many ways for the organs of government, because the
18 central banks have a common interest and a common
19 business the whole time and are actually doing a good
20 deal of business together and are probably looking
21 at very similar problems all day and every day. We
22 have made a practice of having not only the top
23 people but a number of executive directors and senior
24 officials travelling around the Commonwealth a great
25 deal, and I think it is probably true to say that there
26 has been no time during the time I have been at the
27 Bank of England when we haven't known broadly what is
28 in the minds of the Bank of Canada, Reserve Bank of
29 Australia, New Zealand, and around the Commonwealth
30 generally, and when they have not known what is in our

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in the minds of the Bank of Canada, Reserve Bank of
Australia, and so on, and when they have not known what is in our



1 mind, and I believe that has been a very beneficial
2 exercise.

3 The same thing is true of our contacts with
4 the European banks. I think I have already said we have
5 always kept extremely close with the Federal Reserve
6 System in the United States, and I think my
7 Commonwealth colleagues would agree the Bank of England's
8 close relations and connections in Europe, directly with
9 the European central banks and through the Bank of
10 International Settlements have made the services which
11 the Bank of England can render to the Commonwealth
12 central banks considerably greater than they would have
13 otherwise been. We are very close to the European
14 scene, and by the connections which we have maintained
15 with the Commonwealth I think we have been able to
16 keep them pretty well informed about what is going on
17 in Europe generally. These individual contacts are,
18 I think, going on and increasing all the time, and they
19 have since the war been supplemented by the International
20 Monetary Fund meetings, the meetings of the E.P.U. in
21 Europe, and by the continuing meetings of the Bank for
22 International Settlements.

23 We had in 1961 what was, I think, something
24 of a milestone in the history of central banking
25 co-operation in what are currently known as the
26 Basle arrangements where a number of central banks
27 gave credit facilities to the Bank of England to assist
28 in meeting a wave of speculation, and, in fact, saw
29 that out successfully with the later co-operation
30 of the International Monetary Fund.



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of the International Monetary Fund.



1 I believe, myself, that those arrangements
2 are a good augury for the future, and show a road
3 which can be pursued with great advantage, and it is
4 certainly my hope that central banking co-operation
5 on those lines will continue and will be intensified.

6 I think that is what I have to say, sir.

7 COMMISSIONER LEMAN: Lord Cobbold, there is
8 one little point here that still puzzles me a bit.
9 Earlier you explained to us that you consider a
10 7 per cent bank rate rather a violent crisis type of
11 action, and that the country would not like to live with
12 that level of rates for a long period. Would you say
13 that the necessity for such action has been brought
14 about by these external factors -- speculative move-
15 ments of hot money and such?

16 LORD COBBOLD: I would put it in a slightly
17 different way, sir: I think they have been necessary
18 to counteract something that was wrong in the internal
19 economy, but it was the pressure of overseas opinion
20 and the foreign exchange crisis, if you like to call it
21 that, that made it necessary to introduce the remedy
22 immediately and quite so suddenly and drastically.

23 COMMISSIONER LEMAN: Because otherwise
24 one would have to conclude that the necessity for
25 doing it was because action had been taken somewhat
26 too late, unless it was an external factor that had
27 come about to force the violent action at one moment.

28 LORD COBBOLD: There may be sometimes a bit
29 of both in it. I think there have been occasions when
30 one could have avoided more drastic action if some



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doing it was because action had been taken somewhat
too late, unless it was an external factor that has
come about to force the violent action at one moment.
LORD COBOLD: There may be sometimes a bit
of both in it. I think there have been occasions when
one could have avoided more drastic action if some



1 lesser action had been taken earlier. But, it is
2 also true that once you begin to take action of that
3 sort, unless you can clearly demonstrate that you are
4 taking full and sufficient action, you may do more
5 harm to overseas confidence than good, and therefore
6 you are probably forced to deal with a disease more
7 quickly and more suddenly and drastically by this
8 overseas question than you might choose to do if you
9 were isolated from the rest of the world.

10 COMMISSIONER LEMAN: Because on relating
11 this to your statement that the court is not concerned
12 with the bank's activities in the foreign exchange
13 end, where the bank acts as agent --

14 LORD COBBOLD: I said, I thought they were
15 not formally concerned, but at the same time we took
16 strong advantage of the individual director's knowledge.

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... to your statement that the court is not concerned
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LORD GODDARD: I said, I thought they were

not formally concerned, but at the same time we look
strong advantage of the individual director's knowledge.



1 COMMISSIONER GIBSON: This brings a question
2 to my mind. You rather implied that Great Britain's
3 dependence on the international situation, their low
4 level of reserves and international indebtedness, at
5 times helped them to do the right thing in the monetary
6 field. I see this point very clearly, but would it
7 be fair to say that it also gets you to go further
8 than you wanted to go on certain occasions?

9 LORD COBBOLD: On certain occasions certainly
10 it was more violent than we should wish. I think
11 it persuaded us -- the authorities or whatever you
12 would like to call us -- that it was necessary to
13 do something. If it had not been for the outside
14 factors one would have thought it more prudent to
15 do it a little more slowly but that would not have
16 done what was necessary in terms of force. There
17 have been one or two occasions like that.

18 COMMISSIONER GIBSON: You may have acted
19 both more suddenly and in a more restrictive way than
20 you otherwise would like to act?

21 LORD COBBOLD: I think that is possible.

22 COMMISSIONER GIBSON: Would you think that
23 this would have anything to do with the slower rate
24 of growth in Great Britain in recent years?

25 LORD COBBOLD: I think I would hazard a
26 guess that if we had not had the overseas liabilities
27 inherited from the war we would have then proceeded
28 on an even keel very much easier.

29 COMMISSIONER GIBSON: And probably would
30 have had a higher net rate of growth over the period?



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dependence on the international situation, their low
level of reserves and international indebtedness, at
times helped them to do the right thing in the monetary
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be fair to say that it also gets you to go further
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LORD CORBETT: On certain occasions certainly

it was more violent than we should wish. I think
it persuaded us -- the authorities or whatever you
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do something. It is hard not to see for the outside
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have been one or two occasions like that.

COMMISSIONER GIBSON: You may have noted

both more audibly and in a more resolute way than
you otherwise would like to act?

LORD CORBETT: I think that is possible.

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1 LORD COBBOLD: I think that is right.

2 COMMISSIONER GIBSON: You say quite a lot
3 about the movements in funds in the freer exchange
4 situation, and I have got the impression that it is a good
5 thing in a way and there are quite a lot of problems
6 about it, too. This, I take it, is the main way in which
7 the central banks are operating today in a practical
8 fashion in trying to lessen or moderate this rapid
9 movement?

10 LORD COBBOLD: And offsetting it, too. I
11 would say perhaps offsetting more than moderating.

12 COMMISSIONER GIBSON: Well, this tendency
13 is obviously increasing as the western world is becoming
14 very much more one place from the economic point of
15 view. Are you concerned about the ease with which money
16 can move around, or do you think this is a good thing?

17 LORD COBBOLD: That depends; I think this
18 is an advantage, but it implies that the leading monetary
19 fiscal authorities must pursue policies not too far out
20 of line with the others or they will be subjected to
21 very violent movements in one direction or the other,
22 and it also means that there must be machinery available,
23 whether through central bank co-operation, plus
24 European arrangements, plus the B.I.S. arrangements and
25 the International Monetary Fund arrangements in order to
26 meet that constant movement and make sure that sudden
27 movement of funds from one place to another will not
28 upset the whole thing.

29 COMMISSIONER GIBSON: And in this process forward
30 foreign exchange rates play quite an important part?



LORD CORBOLD: I think that is right.

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COMMISSIONER GIBSON: And in this process how

foreign exchange rates play quite an important part?



1 LORD COBBOLD: Yes.

2 COMMISSIONER GIBSON: Do you think that
3 this is a proper area for central bank intervention?

4 LORD COBBOLD: There has been a very violent
5 controversy in a number of technical fields and I
6 always hold the opinion that we are much better to keep
7 out of the forward market. I couldn't tell you how that
8 controversy has moved in the last few months.

9 COMMISSIONER GIBSON: You would rather let
10 the funds move and do what is necessary?

11 LORD COBBOLD: I am only talking about
12 London again, but my technical experience on that has
13 always been that if you get into that field it is very
14 difficult to get out and you are very likely to find
15 yourself with international speculation on your back
16 and at your cost, and it is very difficult to get out
17 from under. I would much rather let the rate move
18 out and look after itself. However, that is a personal
19 opinion on a considerably controversial subject.

20 COMMISSIONER GIBSON: Do you think this
21 increasing co-operation among central banks is affecting
22 the importance of the international reserves, gold and
23 key currencies?

24 LORD COBBOLD: I always feel what is most
25 important in this general question of the international
26 liquidity is confidence. I think international
27 liquidity is probably sufficient at the moment provided
28 people have confidence in the stability of the main
29 reserve currencies.

30 There is no doubt whatever that these



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1 arrangements which were made, and the subsequent
2 arrangements, have contributed enormously to a growing
3 feeling of confidence that these things are being looked
4 after, which is what the people want to know.

5 If I may go back a little, you will remember
6 the very considerable upset there was in March of
7 1961, which was I think due in large measure to the
8 feeling that whereas co-operative arrangements under
9 a more or less regularized pattern had been greatly
10 built up after the war, the moment came in March of
11 1961 when this seemed to be done without proper
12 consultation and that the arrangements had rather
13 broken down, and we had to come in in a big way to
14 get over that; partly to deal with the immediate problem
15 that there was, but also to re-establish the feeling that
16 the authorities were co-operating and had the thing
17 in hand, and I believe that last year's International
18 Monetary Fund arrangements made a big contribution to
19 that as well.

20 COMMISSIONER GIBSON: Do you see any serious
21 risk of lack of international liquidity?

22 LORD COBBOLD: Oh well, there could be in
23 certain circumstances, but it had not bothered me so
24 long as I was in the bank.

25 COMMISSIONER GIBSON: From what you say
26 I gather that one of the key factors in this picture
27 in your mind would be confidence in the dollar sterling
28 in maintaining that degree of liquidity?

29 LORD COBBOLD: Yes, confidence in the
30 dollar sterling rate.



United States Department of the Treasury

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COMMISSIONER GIBSON: From what you say

I gather that one of the key factors in this picture in your mind would be confidence in the dollar standing in maintaining that degree of liquidity?

LORD GOSWOLD: Yes, confidence in the

dollar standing rate.



1 COMMISSIONER GIBSON: You have answered the
2 questions in your initial statement pretty thoroughly.
3 I am just wondering if you care to say anything about
4 the Canadian position from a foreign exchange point of
5 view. We operate in somewhat different circumstances
6 and, as you know, we are closely economically associated
7 with the United States both in a trade way and in an
8 investment way; we are subject to very large capital
9 movements and we, as you know, have had a number of
10 problems about what is the appropriate exchange rate
11 policy, and I wonder if you would care to say something
12 about that?

13 LORD COBBOLD: I really don't think I am
14 competent to do so.

15 COMMISSIONER GIBSON: Do you see any reason
16 why we should have a different kind of policy, for
17 example, than the United Kingdom because of our particular
18 position?

19 LORD COBBOLD: In many ways I think you must
20 have to some extent a different kind of policy.

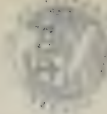
21 COMMISSIONER GIBSON: Well, I don't want to
22 question you on this point if you --

23 LORD COBBOLD: I don't really feel I could
24 make any useful contribution to that.

25 THE CHAIRMAN: We are now finished.

26 LORD COBBOLD: Thank you.

27 THE CHAIRMAN: I may say that we appreciate
28 immensely your assistance. The discussion has been
29 of very great interest from beginning to end, and I
30 just wish to express our thanks and our great



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THE CHAIRMAN: We are now finished.

LORD GORBOULD: Thank you.

THE CHAIRMAN: I may say that no suggestions

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of very great interest from beginning to end, and I

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Toronto, Ontario

1 appreciation for your presence here with us.

2 LORD COBBOLD: Thank you very much. I thank
3 you in my turn for your kindness and courtesy.

4 THE CHAIRMAN: We will adjourn now until
5 9:15 tomorrow morning.

6 ---ADJOURNMENT
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Royal Commission on Banking and Finance

DR. HOLTROP

Hearings
held at
OTTAWA

Vol.

35

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ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Tuesday,
September 11th, 1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary



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THE WITNESSES

The Honourable Denis Harris, former
Chief Justice of Ontario
- Chairman Toronto, Ontario

Mr. W. Thomas Brown, M.B.E.
Vancouver, British Columbia

Mr. James Douglas Gieser, C.B.E.
Toronto, Ontario

Mr. [Name obscured]
[Address obscured]

Mr. Paul H. Lemay
[Address obscured]

Mr. [Name obscured]
Corporation Executive
Kallak, Nova Scotia

Dr. W. A. Macdonald
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H. A. Hanson
Mr. Gilles Mercure
- Joint Secretary



Ottawa, Ontario,
Tuesday, September 11, 1962.

On resuming at 9.20 A.M.

THE CHAIRMAN: Call the meeting to order. We have this morning a submission from Dr. Marius Holtrop of the Netherlands. We welcome you this morning, Dr. Holtrop, and we wish to express our appreciation to you for coming here and giving us what we anticipate will be very great assistance. We have all read your brief with great care and I may say we are all very much impressed with the presentation you have made in it, and I am sure there will be considerable questioning arising out of it. We are delighted to have you here and very grateful to you for coming.

DR. HOLTROP: Thank you, Mr. Chairman. I have no statement to make. I only want to assure you it is a pleasure for me to come to this Commission and help you in the work you are doing.

THE CHAIRMAN: I suggest, Dr. Holtrop, that, there being a number of people in the room who wish to hear you, you keep that in mind; it is sometimes difficult to make yourself heard in this room. I am sure they all want to hear everything you have to say. Do you wish to make a statement?

DR. HOLTROP: No, Mr. Chairman; I have no special statement to make.

As a matter of introduction, I want to stress that my memorandum, of course, is based on my own Dutch experience and on the general approach to the monetary problems, and that I have not specifically

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you wish to make a statement?

DR. HOLTROP: No, Mr. Chairman; I have no

special statement to make.

As a matter of introduction, I want to stress



1 thought of Canadian conditions because I thought it
2 natural you would like to compare the situations in other
3 countries with the Canadian situation. I have no
4 specific knowledge, nor sufficient knowledge of your
5 Canadian conditions to venture opinions about them, and
6 I would only stress that nothing in my paper has any
7 background or suggestion of giving opinions about the
8 situation here. I know it is different, and it would
9 take a lot of study to be able to venture opinions about
10 the situation as we find it in this country.

11 COMMISSIONER BROWN: Dr. Holtrop, perhaps it
12 would serve as an introduction if you would outline for
13 us the organization and management of the Netherlands
14 Central Bank.

15 DR. HOLTROP: I would be glad to, Mr. Chairman.
16 The organization of the Netherlands Bank is perhaps only
17 to be understood quite clearly when one takes into
18 consideration that it is a very old institution which
19 has evolved. The Netherlands Bank was created in 1814
20 as a general bank with the special right of note issue
21 and with private shareholders.

22 It was nationalized just after the war.
23 Shares were taken over by the government, but the
24 nationalization has not brought very much change in its
25 structure; practically none, I would say. The conse-
26 quence is that it is still that kind of a limited
27 liability company under Dutch law with some special
28 rules which do not apply to other limited liability
29 companies, because the shareholders do not have
30 specific rights of great importance. They have
no great rights, because previously, under the



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rules which do not apply to other limited liability
companies, because the shareholders do not have
specific rights of great importance. They have



1 charter of the bank, it was thought right the shareholders
2 should not influence the business of the bank too much.
3 So, we find an institution where most of the executive
4 powers are in the board of management, the managing
5 directors, where there is a board of commissioners which,
6 for internal purposes, controls the board of management,
7 a board of commissioners which convenes only once a month,
8 in which one member specially represents the government.
9 He is the Royal commissioner and he is the one who
10 reports also to the minister if he thinks it necessary
11 about the goings on in the bank and discussions between
12 the board of commissioners and the management.

13 Then, there was created in the Bank Act of
14 1947 a second body called the bank council. The bank
15 council is a body which is advisory to the minister of fin-
16 ance in all matters pertaining/It can take the initiative
17 itself, but usually it has to be consulted by the
18 minister of finance in those cases where the law gives
19 the minister of finance specific powers in relation
20 to the bank's business. The bank council is a body
21 which, as expressed by the Act, is the representation
22 of the total community in the bank. It consists of 17
23 members who are appointed by the Crown and who are
24 nominated by specific groups that are indicated by the
25 law or by special Royal decree. These special groups who
26 make these nominations are, for example, the employers
27 associations to represent trade and industry and commerce;
28 the trade unions to represent labour; agriculture is
29 represented; transportation is represented; banking is
30 represented; the stock exchange is represented; economic



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 associations to represent trade and industry and commerce;
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 represented; the stock exchange is represented; economic



1 science is represented. So, this is a broad body
2 representing all sorts of aspects of the total life of
3 the community and, as I say, acts in an advisory capacity.
4 It convenes at least six times a year.

5 The president of the bank has to report about
6 current economic conditions to this body, and on the
7 basis of these reports, and bank policies, of course,
8 there are general discussions about the policies of the
9 bank and about the conditions, and this is a two-way
10 affair. We think it is a very important thing. It has
11 two ways of influencing: it is a body that gives the
12 management of the bank the opportunity to consult people
13 out of different shades of life, about how their
14 thinking is in the sphere of bank policy or the
15 sphere of economic development. Also the management
16 of the bank conveys monetary thinking to that body, and
17 that body is a high representation of the community:
18 for example, I think I mentioned in my brief, the
19 presidents of the three great trade unions in the country
20 are in the body and it gives an opportunity to explain
21 monetary policies also to those people. So, I think it
22 is a very useful body for the exchange of information
23 both ways.

24 The actual powers in the bank, that is,
25 the powers of decision, are concentrated in the board of
26 management which is appointed by the Crown on nominations
27 made by the board of commissioners. The Crown can appoint
28 the president outside the nomination if it thinks fit,
29 after having sent back the nomination a few times.

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1 that there is a strong influence in the appointment
2 of the management of the bank to the body of the bank
3 itself. It is kind of an influence of perpetuation and
4 keeping it in the professional sphere. As far as I can
5 judge, all appointments for the management of the bank have
6 been of a completely non-political nature.

7 A very important thing in the relationship
8 between bank and government is the right of the minister
9 of finance to give directives to the bank management
10 in case he considers it necessary to co-ordinate the
11 monetary policies of the bank and the government, so that
12 in case of a difference in monetary policies, then the
13 minister of finance can give directives to the management.
14 The management, though, has the right to appeal to the
15 Crown. That means, in a constitutional monarchy as
16 ours is, appeal really to the council of ministers.
17 The council of ministers will have to decide, and there
18 is for all normal circumstances the obligation of public-
19 ation of the briefs exchanged and the differences of
20 opinion that have come out in the official gazette.
21 This right of giving directives has never been used yet
22 but it is, of course, fundamental to the background of the
23 relationship between the ministry of finance and the bank.
24 So, I think it is a very satisfactory setup in so far
25 as it is necessary, that in the end there should be one
26 captain on a ship. When there is really deep differences
27 of opinion about the execution of monetary policy between
28 bank and government there must be a solution, and that
29 solution can be forced by this right of directive. On
30 the other hand, the right of directive cannot be taken



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1 lightly, so that there is a kind of equity created that
2 way in consultation between the bank and the ministry of
3 finance about policies, if that is necessary.

4 I should say that in practice we feel that
5 the bank's business is to be considered mainly
6 the bank's responsibility under normal circumstances,
7 while, of course, the business of the ministry of finance
8 is completely the responsibility of the ministry of
9 finance, and in practical life we have not found great
10 difficulties there in the period of my office, which is
11 since 1946.

12 I think those are the most important features
13 of the setup of the bank. If I have forgotten any point
14 which you think is of interest, I might invite a question
15 about it. This is a general outline of what is of
16 importance.

17 COMMISSIONER BROWN: You mentioned the board
18 of commissioners that meets once a month. That is more
19 frequently than the bank council?

20 DR. HOLTROP: Yes.

21 COMMISSIONER BROWN: How big a body is this,
22 and who appoints them? What power have they got?

23 DR. HOLTROP: The board of commissioners is
24 a board of 12 members. The board of commissioners can
25 really only be understood from the point of view of
26 Dutch company law, and they were originally the only
27 controlling body of the bank management. The board of
28 commissioners in Dutch law takes somewhat the place of
29 the board of directors under British law. Its powers
30 are slightly less because they are not generally



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28 the board of directors under British law. It covers

29 the slightly more general powers of control.



1 responsible for the management. They are controlling
2 the management for the benefit of the shareholders. They
3 may by statute have certain powers, but then it has to
4 be explicitly given by statute. Certain decisions of
5 the management may have to be referred to the board of
6 commissioners, but that is not necessarily so. They
7 are the body in company law, therefore, that controls
8 the directors and makes the nominations also for new
9 directors. In the bank they have been given a single
10 bigger power because they are the ones who approve the
11 balance sheet of the bank which generally, under Dutch
12 company law, is a power of the meeting of shareholders,
13 but, as I said, shareholders of the bank never had the
14 full powers of shareholders as they have in other limited
15 liability companies, and this power was given to the
16 board of commissioners, so that they approve the balance
17 sheet.

18 The purpose of the present banking act has
19 been to make a certain difference between these two bodies,
20 inasmuch ~~as~~ the bank council should be more the body
21 that occupies itself specifically with bank policies,
22 with monetary policy, while the board of commissioners is
23 the body that is concerned with the organization and
24 with the finances of the bank, with the internal organization,
25 and all sorts of questions that come up there: so, it
26 is questions of household, ~~of profits and losses~~, questions
27 of management and questions of salaries, and all that
28 kind of thing which comes into the board of commissioners.

29 COMMISSIONER BROWN: How are they appointed?

30 DR. HOLTROP: They are appointed by shareholders,

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COMMISSIONER BROWN: How are they appointed?



1 which practically means now, of course, the minister
2 of finance because he represents the state as the only
3 shareholder; but they are appointed on a nomination
4 which is made by the joint meeting of the bank council
5 and the board of commissioners itself. So, again,
6 there is the tendency of giving the bank itself a strong
7 influence in perpetuating the bodies that control the
8 bank. The minister of finance, as representative
9 shareholder, cannot go outside that nomination.

10 COMMISSIONER BROWN: Is there an interlocking
11 or an overlapping between the two bodies?

12 DR. HOLTROP: There are four members of the
13 board of commissioners who are also members of the bank
14 council. That is the link between the two.

15 COMMISSIONER BROWN: But the actual responsibility
16 for operating, for changing the bank rate ...?

17 DR. HOLTROP: Is with the board of
18 management only.

19 COMMISSIONER BROWN: And this consists of
20 the president ...?

21 DR. HOLTROP: The president with four to six
22 managing directors. We presently have four, so that we
23 are a body of five people, which has a joint responsibility.
24 This is, again, like the general position in Dutch company
25 law: Dutch limited liability companies mostly have
26 a board of managing directors that may be two or four
27 or five who have a joint responsibility. Each of them
28 bind the company legally and ^{they} take their decisions jointly,
29 and the position of the president is that he has a
30 deciding vote in the case of a tying vote. But, as a



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of finance, because he represents the state as the only

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1 matter of principle the president can be out-voted
2 in the board of directors. It does not happen very much,
3 but that is the legal position.

4 COMMISSIONER BROWN: Well, this managing
5 board must meet continually?

6 DR. HOLTROP: It meets continually; we meet
7 every day, yes. This managing board is, of course,
8 comparable with what you know as the executive directors
9 of the Bank of England -- the ones who are permanently
10 there.

11 COMMISSIONER BROWN: They come up through
12 the bank service?

13 DR. HOLTROP: They may or may not. There
14 are always several managing directors who have come
15 up through the bank service, but there are also some
16 who may have come from the outside. I would say it is
17 usual that the president comes from the outside. Among
18 my present colleagues -- and we are five -- there are
19 three who really have had a long career with the bank
20 before becoming managing directors; one left the bank
21 and later came back as a managing director, and one of
22 my colleagues was a banker and came into the bank from
23 private banking. I, myself, came from industry.

24 COMMISSIONER BROWN: What are the terms of
25 appointment?

26 DR. HOLTROP: We are all appointed for a period
27 of seven years, and we cannot be discharged unless we
28 are impeached for extremely special reasons. So this
29 is a fixed appointment for seven years, and it is usual,
30 one must say, that these appointments are continued.



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COMMISSIONER BROWN: What are the terms of

say, that these appointments are continued.



1 So, once a director, the usual thing is that a director
2 continues until the pensionable age.

3 COMMISSIONER BROWN: What are the terms of
4 appointment to the bank council and board of commissioners?

5 DR. HOLTROP: I think they are all four-year
6 terms. The board of commissioners has a four-year term --
7 yes, both of them have. They fall due according to a
8 certain schedule, and they come up for re-appointment
9 after that period.
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certain schedule, and they come up for re-appointment
after that period.



1 COMMISSIONER BROWN: In practice do you
2 get an opportunity or does the management board get
3 an opportunity to suggest these nominations?

4 DR. HOLTROP: We might be consulted,
5 yes; because the Board of Commissioners as a matter
6 of fact mostly has meetings together with the managing
7 board, so we have a joint meeting of the managing
8 board and the Board of Commissioners. Of course,
9 these nominations are formally not our business;
10 we may venture opinions, but we never try to influence
11 these nominations, we leave that to the members who are
12 formally concerned with making the nominations.

13 COMMISSIONER BROWN: Thank you very
14 much.

15 COMMISSIONER GIBSON: To change the
16 subject a little, I would like to ask you to
17 elaborate a bit more on the question of the objectives
18 of monetary policy. You have put a little different
19 emphasis on this than some other bankers and you
20 stated that the primary objective was to maintain
21 the internal and external value of the monetary unit
22 under conditions of reasonable employment. You said
23 that the maintenance of full employment, while
24 obviously a major objective of a national economic



COMMISSIONER GIBSON: The question is whether

the Board of Commissioners is authorized to

or not to do so.

DR. KOTTHOFF: We might be consulted,

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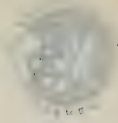
obviously a major objective of a national economic



1 policy must necessarily be a secondary objective of
2 monetary policy and you don't in the memorandum mention
3 it -- I don't think you are referring to growth as
4 an objective, although perhaps that is included in
5 full employment.

6 I wondered if you could say a little
7 more about the conflicts between the objectives, the
8 two-fold objective which you mentioned and the primary
9 one, that is, the maintenance of the internal and
10 external value of the currency, and perhaps if one
11 were to do that it would bring out a little more
12 some of the possible conflicts in connection with
13 the secondary objectives. In other words, as
14 you said, there are times when the two-fold objectives
15 of maintaining the internal-external value of the
16 currency are in conflict, and these are not infrequent
17 occasions, and I am wondering if you would give us
18 a few examples of the times when they are in conflict
19 and what you would think was an appropriate policy
20 under these conditions -- perhaps rather extreme
21 examples -- is this a reasonable question to put to
22 you?

23 DR. HOLTROP: I think the question by
24 itself is reasonable enough, although it is not so
25 easy to answer in the abstract because it is difficult
26 then to circumscribe all the circumstances that might
27 occur in certain moments, but I would like to elaborate
28 on that because I know I have given a little different
29 stress than is sometimes given, and the remarkable
30 thing is -- in a way it is remarkable -- that I do



policy must necessarily be a secondary objective of monetary policy and you don't in the memorandum mention it -- I don't think you are referring to growth as an objective, although perhaps that is included in full employment.

I wondered if you could say a little more about the conflicts between the objectives, the two-fold objective which you mentioned and the primary one, that is, the maintenance of the internal and external value of the currency, and perhaps if one were to do that it would bring out a little more some of the possible conflicts in connection with the secondary objectives. In other words, as you said, there are times when the two-fold objective of maintaining the internal-external value of the currency are in conflict, and these are not infrequent occasions, and I am wondering if you would give us a few examples of the times when they are in conflict and what you would think was an appropriate policy under these conditions -- perhaps rather extreme examples -- is this a reasonable question to put to you?

DR. HOLTROP: I think the question by itself is reasonable enough, although it is not so easy to answer in the abstract because it is difficult then to circumscribe all the circumstances that might occur in certain moments, but I would like to elaborate on that because I know I have given a little different stress than is sometimes given, and the reasonable thing is -- in a way it is remarkable -- that I do



1 give this stress not only out of full conviction my-
2 self, but that it is also the stress that is given
3 in the Bank Act, the Netherlands Bank Act. Article 9
4 of the Netherlands Bank Act states what the task
5 of the Netherlands Bank is, and in that description
6 of the task of the Netherlands bank it says that
7 the object and the policy of the bank should be to
8 maintain the internal and the external value of
9 the monetary unit -- no, it says to regulate. The
10 Bank Act says that it is the task of the Netherlands
11 bank to regulate the value of the monetary unit in
12 such a way that it is most conducive to the interests
13 of the country.

14 When you then ask what is meant and
15 what can be meant by the value of the monetary unit
16 you immediately come to that difference between the
17 internal and the external value, and you have to
18 realize that our Bank Act does not go into
19 this; it only says it should try to stabilize as
20 much as possible that value.

21 Now, theoretically, when
22 we ask ourselves what we mean by the value of money,
23 we immediately come to the problem of the internal
24 and external value, and we have to distinguish between
25 the value of money in the sense of purchasing power
26 and the value of money in the sense of the exchange
27 rate; the relationship between one monetary unit and
28 another monetary unit. Since we live in a world
29 in which, and have lived for a long time in a world
30 in which we need stable rates of exchange, and we have



THE NETHERLANDS BANK ACT, 1913, AND THE NETHERLANDS BANK ACT, 1914.

in the Bank Act, the Netherlands Bank Act. Article 2 of the Netherlands Bank Act states what the task of the Netherlands Bank is, and it says that of the task of the Netherlands Bank it says that the object and the policy of the bank should be to maintain the internal and the external value of the monetary unit -- no, it says to regulate. The Bank Act says that it is the task of the Netherlands Bank to regulate the value of the monetary unit in such a way that it is most conducive to the interests of the country.

When you then ask what is meant and what can be meant by the value of the monetary unit you immediately come to that difference between the internal and the external value, and you have to realize that our Bank Act does not go into that; it only says it should try to stabilize as much as possible that value.

Now, theoretically, when we ask ourselves what we mean by the value of money, we immediately come to the problem of the internal and external value, and we have to distinguish between the value of money in the sense of purchasing power and the value of money in the sense of the exchange rate; the relationship between one monetary unit and another monetary unit. Since we live in a world in which, and have lived for a long time in a world in which we need stable rates of exchange, and we have



1 proceeded to maintain these stable rates of exchange,
2 it is obvious to us that one of the primary tasks
3 of the central bank is, indeed, to perpetuate the
4 conditions which are conducive to the maintenance
5 of the external value of the monetary unit; that is,
6 to maintain the exchange rates or the parity of the
7 monetary unit.

8 On the other hand, we agree that it is
9 the purpose of monetary policy to maintain the value
10 of money; that is, the purchasing power of money.
11 That brings up, indeed, a question of definition,
12 what you mean by the purchasing power; what purchasing
13 power, is it the cost of living, is it the wholesale
14 prices; what kind of index do you mean? Now, on the
15 other hand this brings in all sorts of questions of
16 detail. We have a general notion of what we mean by
17 maintaining the purchasing power of money.

18 Now, I think that these two, under
19 certain circumstances may clash, because maintaining
20 the purchasing power of value may clash with maintaining
21 the exchange of stability in cases where in the outside
22 world there are no conditions of equilibrium but either
23 a deflation as we have known them in the thirties,
24 or inflationary conditions as we have known them
25 in the forties, and then the purposes of maintaining
26 the internal and external value may come into contra-
27 diction with one another, as I have explained here,
28 and also in my brief, and in a certain moment the
29
30



1 monetary authorities may have to decide between the
2 one and the other.

3 Now you may remember that in my memo
4 I have taken the position that by monetary policy
5 generally I mean more than only central bank policy,
6 and I think that it is a mistake, really -- I know
7 that it is widely being done -- but there is a
8 kind of tendency to use the phrase "monetary policy"
9 for "central bank policy" only, and I think that it
10 leads to unclear thinking if you do this and it is
11 a danger not to recognize that monetary policy is the
12 whole field of monetary management and that central
13 bank policy is only part of it.

14 I think that central bank policy, while
15 it has to choose between the two -- I mean, maintaining
16 a certain parity and maintaining the internal purchasing
17 power -- must give some preference to the external
18 value because the instruments of policy which the
19 central bank controls are instruments of policy which
20 are more conducive, more ready to be used for the
21 purpose of maintaining the external purchasing power
22 than the internal purchasing power. But in certain
23 moments the country must come to the point where it
24 has to clearly choose between the two, and our
25 country has been over this and your country has
26 been also, and these moments may come, where, indeed,
27 a choice has to be made between internal and external
28 stability and either a decision for devaluation or re-
29
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stability and either a decision for devaluation or re-



1 valuation, that is, a change in the external parity,
2 may have to be taken.

3 COMMISSIONER GIBSON: You made such a
4 decision quite recently, didn't you?

5 DR. HOLTROP: We made such a decision
6 quite recently and that is, of course, the type
7 of decision in which the opinion of the government,
8 prevails above the opinion of the central bank. It
9 is too important a decision to be left to the central
10 bank. It is a government decision but, indeed, that
11 type of clash may come, and accordingly a decision
12 has to be taken.

13 Now, your question was about the
14 relationship between this purpose and the purpose
15 of full employment or the purpose of growth.

16 My approach to monetary problems is,
17 after all, that monetary policy as such is an
18 instrument which has the purpose of creating the
19 most favourable monetary conditions, and by "monetary
20 conditions" I specifically think, indeed, of the
21 disturbances that can possibly be caused in the
22 economy by the use of the instrument of money.

23 The fundamental thing about the use of money is,
24 indeed, that by the use of money we have created
25 a split between the act of supply and the act of demand;

26 it is possible to supply without demanding because you can
27 hoard the money and you create a disturbance because
28 that way you create an over-supply to demand, and
29 the reverse is also possible by the use of money;
30 if you have stored up money or you can create new



Statement of Mr. R. H. S. [illegible]

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1 money you can demand, you can execute a demand
2 on the market without supplying anything, and that
3 is fundamentally what we mean by deflationary and
4 inflationary influences. That is the monetary
5 approach to the problems, and in my opinion the
6 fundamental purpose of monetary policy should be
7 and ought to be to reduce these types of disturbances
8 to the minimum. You can never achieve 100 per
9 cent there, that is impossible because you haven't
10 the possibility of observation, where an excess demand
11 occurs. Yet the purpose of monetary policy should
12 be to create conditions of stable demand against
13 the possibilities of supply, and to create that
14 equilibrium of demand and supply in conditions of
15 what I have called "reasonably full employment".
16 I will just mention in this connection that it is
17 only a few years ago that in Holland we considered
18 3 per cent unemployment as the point where distur-
19 bance about the employment situation was ready to
20 come up, but we have now gone through several years
21 of one per cent unemployment and I am conscious of the
22 fact that 3 per cent unemployment at the present
23 moment would be considered a disastrous condition,
24 while in the late fifties we still considered
25 3 per cent unemployment fairly satisfactory, and
26 as giving no reason for specific policies to
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1
2 combat unemployment if it wouldn't be larger
3 than 3 per cent.

4 Now, to come back to monetary policy.

5 It is my opinion that monetary policy should only
6 be used to combat monetary disturbances, and if
7 unemployment is caused by monetary disturbances then
8 it is, indeed, the task of monetary policy to combat
9 that condition. But it is also conceivable that
10 unemployment is the consequence of quite other
11 causes, such as wage policies, price policies, inter-
12 national shift of demand, and there I only want
13 to stress the point that I think it would be
14 completely wrong to believe that you could use
15 monetary policy to correct conditions that are
16 caused by other than monetary disturbances. When
17 the conditions that have created unemployment have
18 no monetary character, I don't believe that monetary
19 policy can be used to combat those conditions, and
20 if you did you are certainly going to come into
21 conflict with other purposes of monetary policy,
22 and therefore I have stressed this point and I have
23 said that the purpose of monetary policy is to create con-
24 ~~ditions of stable demand~~, conditions of stability of the

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ditions of stable demand, conditions of stability of the



1 internal and external value of the monetary unit
2 under conditions of reasonably full employment.

3 If you haven't got those conditions
4 of satisfactory employment it is a question of
5 investigation into the causes of that condition
6 that could give you a solution to the instrument
7 of policy that could be used to create that condi-
8 tion, and it is not a natural conclusion that you
9 could use monetary policy to create that condition.
10 One might take an extreme example to make that clear.
11 I have been told that you had a uranium boom in this
12 country at a certain moment and suddenly the demand
13 for uranium went down. That no doubt must have
14 created conditions of unemployment in those centres
15 which produced uranium. You couldn't combat that
16 with monetary policy because you couldn't create a
17 demand for uranium that way.



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1 There I have given an example of a clear
2 and extreme case where it is easily recognizable that
3 certain disturbances have caused the condition, and
4 that the instruments of policy to be used in correcting
5 those disturbances should be sought in the direction of
6 the cause of the disturbances. It is for this reason
7 that I have stressed these differences.

8 Of course, here I may mention that I am
9 labouring under some difficulty of language. When
10 I use the word "secondary" I do not know for sure
11 whether that conveys to you anything of a derogatory
12 connotation; if so then let me say that I do not
13 mean that. When I describe something as primary I
14 mean it is the thing that is really closely connected with
15 a subject, and that secondary things are the ones that
16 come in only as a second instance but which to a
17 certain extent may play a role but which in the end
18 cannot play the final role.

19
20 THE CHAIRMAN: I think you mean "less
21 closely connected with monetary policy".

22 DR. HOLTROP: Yes, that is right --
23 less closely connected.

24 COMMISSIONER GIBSON: Conceptually, Dr.
25 Holtrop, I understand your point very clearly, but as
26 a practical matter are there not many cases where it is
27 very hard to decide whether there is monetary dis-



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1 equilibrium or not, and do you not, in fact, have to
2 look on the side of various economic measures as well
3 as monetary balance in deciding just when to move in?

4 DR. HOLTROP: Oh, yes, we definitely do.

5 I have mentioned the employment situation as one of the
6 indicators which are of importance in judging a monetary
7 policy.

8 In my own country we have had different
9 experiences. I remember that we had a lot of unemployment
10 after the Korea boom in the period from 1951 to 1953.
11 At that time unemployment figures were rather high,
12 but then I know that the government made a study of that
13 type of unemployment, and the labour bureaux did also,
14 and we were clever enough to distinguish between cyclical
15 unemployment and structural unemployment and other
16 sorts of unemployment. That is the approach we took.
17 We applied the best kind of thinking we could to a certain
18 problem, and we gave it the best kind of analysis without
19 it being all arithmetic, and we definitely came to the
20 conclusion that it can be recognized that there are
21 parts of the country in which unemployment was occasionally
22 due to the fact of improvement in techniques. For example,
23 improvement in agricultural techniques made agricultural
24 labour redundant, and there were pockets of rather
25 high unemployment for that reason. In those cases the
26 government very rightly considered that it could not
27 do anything about that by a general monetary policy.

28 In those areas the government took decisions
29 as to specific policies directed to those regions which
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In those areas the Government took decisions as to specific policies directed to those regions which facilitated the establishment of new industries there to



1 combat the local unemployment which was created by
2 those specific conditions.

3 On the other hand, of course, we, at the
4 same time, had a general policy of lowering our discount
5 rate, of making credit conditions easier and of allowing
6 the government to have a deficitary budget. Those
7 were means of purely monetary action which were meant
8 to improve the general conditions, but without forgetting
9 that there were specific reasons for specific parts
10 of the problem, and not relying on the idea that by
11 monetary policy alone you could cope with the problem
12 as a whole.

13 I think that is important. It is important,
14 also, to make that distinction when talking about monetary
15 policy because I find that in other countries there
16 has been a tendency to accept monetary policy as a kind
17 of a cure-all, whereas monetary policy in the sense
18 of central banking policy can only be used as a means
19 of just improving the general conditions.

20 When we talk about growth it is quite clear
21 that the determinants of growth cannot be found in
22 general demand only. The determinants of growth can
23 be found in a lot of other things such as education,
24 and also in the volume of savings and the amount of
25 investment. These are all things that cannot be
26 controlled by monetary policy.

27 COMMISSIONER GIBSON: Going back to your
28 example, in 1952 you had an under-employment problem?

29 DR. HOLTROP: Yes.
30



1 COMMISSIONER GIBSON: Did you ease monetary
2 conditions more than you would have in terms of
3 the purely monetary measures because it was an under-
4 employment problem, or did you do just what you felt
5 was right in the monetary circumstances?

6 DR. HOLTROP: I would not pretend -- certainly
7 not at that time -- that we would be able to so closely
8 assess quantitatively what we could do in the one field
9 and in the other, but certainly at that moment we eased
10 monetary conditions. At that time it was also clear
11 that the expansion of banking credit was almost
12 negligible, as you usually find in a period of recession.
13 You find that easing monetary conditions does not lead
14 to a strong upsurge in expenditures. You have to ride
15 out the period of recession in a way, and create the
16 conditions in which it is easy for business to pick up
17 as soon as it feels like picking up.

18 COMMISSIONER GIBSON: Are you concerned about
19 creating too much so that later there may be difficulty?

20 DR. HOLTROP: No, we have not been concerned
21 with that because, actually, there was not that condition.
22 You might be concerned with that from the point of view
23 of budgetary policy. My general contention would be
24 that central bank policy, which is monetary policy,
25 as applied to the private sector of the economy, has not
26 the power to exaggerate money creation in times of
27 recession because the economy just will not take it.
28 Monetary policy in that sense is most active in a period
29 of boom because there the restrictive forces of monetary
30 policy by the central bank can really be of importance.



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1 COMMISSIONER GIBSON: But you can make the
2 banks so liquid that later on there will have to be
3 a big expansion; is not that right?

4 DR. HOLTROP: Theoretically, no -- not under
5 our Dutch conditions, at any rate. It would always
6 be within your control to take away that liquidity later,
7 I think. In my experience I have never coped with the
8 problem of central bank policy being too expansionary
9 in a period of recession because you really have not
10 got the opportunity.

11 COMMISSIONER GIBSON: Why is that? I would have
12 thought that under North American conditions this was
13 eminently possible, that a state of liquidity might be
14 created that might embarrass you later on. You say
15 this is not feasible in Holland on the part of the central
16 bank. This is one of the things that worries our people
17 at times. I was a very big proponent of it after the war.

18 DR. HOLTROP: Yes. There is again that
19 difference of conditions between different countries.
20 I would still maintain that in Holland you would not
21 try to do it because it would not help. Making the
22 banks more liquid in that kind of period would only
23 be possible by buying short-term paper out of the portfolio
24 of the banks for the portfolio of the central bank.
25 This would add to the liquidity of the banking system
26 without having much influence, in my opinion, under our
27 conditions on their active policies.

28 I know that in the United States that would
29 be somewhat different because the banking system in
30 the United States would be induced to go into more long-term



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1 financing -- long-term portfolio investment -- which
2 is not the habit of our banking system. Our banking
3 system, for practical purposes, does not go into long-term
4 portfolio investment, so you could not, under our
5 Dutch conditions, influence very much the capital market
6 conditions by your monetary policy in a period of
7 recession-- at least, not to a big extent. I admit
8 that under the conditions in the United States you could,
9 and that there the danger might arise of creating too
10 much liquidity which you could not control in a later
11 period when suddenly the private sector would feel like
12 spending.

13 COMMISSIONER GIBSON: The liquidity created
14 by your government is a much smaller problem than the
15 problem we have here?

16 DR. HOLTROP: It has become a much smaller
17 problem. It was a very big problem just after the war.
18 We have reduced very much our short-term debts since
19 the war days, and we actually had until, I would say,
20 about 1952 a condition of over-liquidity in the country.
21 It was a kind of a permanent condition of over-liquidity
22 which also came out in very low long-term interest rates.
23 We had a period when our long-term interest rates were
24 in the neighbourhood of 3 per cent. That was a natural
25 condition. It was not purposely created. It was the
26 result of an over-supply of liquidity from the war period
27 of inflation which was not completely mopped up by
28 the after-war measures. I would say that that gradually
29 disappeared from about the early 50's.

30 COMMISSIONER GIBSON: How is it, sir, that the



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is not the kind of investment which

system, for practical purposes, does not go into long-term

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like to see some discussion of the danger of creating too

much liquidity which you could not control in a later

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spending.

COMMISSIONER GIBSON: The liquidity created

by your government is a much smaller problem than the

problem we have here.

MR. WILSON: It has become a much smaller

problem. It was a very big problem just after the war.

We have reduced very much our short-term debts since

the war days, and we actually had until, I would say,

about 1932 a condition of over-liquidity in the country.

It was a kind of a permanent condition of over-liquidity

which also came out in very low long-term interest rates.

We had a period when our long-term interest rates were

in the neighborhood of 3 per cent. That was a natural

condition. It was not purposely created. It was the

result of an over-supply of liquidity from the war period

of inflation which was not completely wiped up by

the after-war measures. I would say that that gradually

disappeared from about the early 20's.

COMMISSIONER GIBSON: How is it, sir, that the

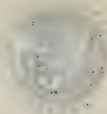


1 record of your country seems to be quite a little
2 different from the records of a number of your partners
3 in the European common market, and from those of the
4 United States, Canada and Great Britain? You have got
5 your national debt down more. You put much more emphasis --
6 I am expressing a view -- on the value of your currency,
7 particularly its external value. You do not use open
8 market operations to any major degree as an instrument
9 of monetary policy and that is largely because, I take it,
10 you do not have a large short-term debt. How do you
11 explain this more prudent record as compared with the
12 rest of the world? At the same time you have achieved
13 a very high level of employment throughout the whole
14 of the post-war period.

15 DR. HOLTROP: I think, in the first instance,
16 that the European countries in the 40's at certain times
17 made their mistakes in internal policy, and they have
18 concluded that these mistakes lead to great difficulties
19 and also to external deficits.

20 If you go back into the history of these
21 European countries you will find that one after the other
22 has been in balance of payments difficulties, and so
23 has Germany. Germany was quite a problem in the late
24 40's, and we had to study the German case. I remember
25 Per Jacobsen going to Germany for the B.I.S. to study
26 the background of the German deficit.

27 We have come to the conclusion that inflationary
28 policies by government lead to balance of payments
29 deficits in the end, and since we could not cope with
30 balance of payments deficits we rightly came to the



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1 conclusion that the monetary policies of the government
2 were a very important part of the general monetary
3 conditions.

4 COMMISSIONER GIBSON: So your great dependence
5 on external trade helps you to reach these conclusions?

6 DR. HOLTROP: In my opinion that is definitely
7 so. I am always conscious of the fact that we, as a
8 small country with our high percentage of external trade
9 have a problem in respect of balance of payments, and
10 that there is a great reaction between balance of
11 payments and monetary conditions.

12 Also, we have found it easier to explain
13 monetary policies to the people. We have not found that
14 very difficult. We have gone through several
15 crises. There was one in 1951 at the time of the
16 Korea boom which was caused by our internal boom which
17 was based partly on old liquidity. There you have that
18 example of existing liquidity that had never been
19 completely mopped up and which could not be controlled
20 because, after all, you cannot prevent people from
21 using their own liquidity. At that time we had a strong
22 boom which led to a bad balance of payments deficit.
23 But, at that moment, we did not find it difficult to
24 explain to our people, including the trade unions, and
25 all those who partook in the general consultations about
26 the general economic conditions, that we were actually
27 in a condition of over-expenditure and that we simply
28 spent more than we earned and that we could not continue
29 to do so. They understood that the only way to improve
30 upon that condition was to cut down on our total



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1 expenditure.

2 That was the period in 1951 when we agreed
3 which the trade unions -- and this was quite exceptional --
4 that real wages should be reduced. It was in an indirect
5 way, but as a consequence of the Korea boom the cost
6 of living went up, and we agreed at that time that
7 it was unavoidable and that we must let the cost of
8 living go up by 10 per cent and allow wages to go up
9 by only 5 per cent which compensated in part for the
10 increase in the cost of living. We did that in order
11 to get the total economy into equilibrium again.

12 COMMISSIONER GIBSON: That is why you did not
13 have much unemployment?

14 DR. HOLTROP: At that time during the boom,
15 of course, we had no great unemployment.

16 COMMISSIONER GIBSON: I mean after the boom
17 of 1952.

18 DR. HOLTROP: The recession of 1952 led to over
19 3 per cent unemployment -- yes, definitely. Once you
20 are out of equilibrium the process of getting back into
21 equilibrium again is generally a painful process in which
22 you can hardly avoid going past the equilibrium point
23 over to the other side. It is a wave movement. Indeed,
24 you might say that the fighting of the over-expenditure
25 of the Korea boom has been one of the causes of a kind
26 of recession after that in 1952-1953. We, therefore,
27 had a period of too high unemployment, and then there
28 were periods in which we started to introduce again an
29 expansionary policy. That was in a period when we
30 had a surplus after the big deficits we had after the

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1 boom period.

2 COMMISSIONER GIBSON: How much of an increase
3 in your cost of living have you had since 1950?

4 DR. HOLTROP: I would not know it since 1950,
5 but I think since 1953 our increase in the cost of living
6 has been 24 per cent. That is rather high.

7 COMMISSIONER GIBSON: That is about 2 per cent
8 a year.

9 DR. HOLTROP: Yes, or $2\frac{1}{2}$ per cent a year.
10 It is in that neighbourhood. This increase in the cost
11 of living in Holland is, in my opinion, part of the
12 process of increasing real wages also, because wages
13 in that same period went up by some 60 per cent. The
14 increase in the cost of living was, of course, partly
15 the result of services getting more expensive as a
16 consequence of the increase in wages, and also of
17 controlled prices gradually being adapted to the new
18 conditions, and in this respect I am thinking especially
19 of house rents which although still under control have
20 periodically been increased which has, therefore, increased
21 the cost of living.

22 COMMISSIONER GIBSON: In other words, you
23 would say part of the increase in the cost of living
24 is not real in the sense that it simply reflects higher
25 wages that are being paid for services?

26 DR. HOLTROP: It was real in a sense, but it
27 was unavoidable in a way if you look at it on the basis
28 of stable international prices.

29 COMMISSIONER GIBSON: Is that a tolerable
30 situation, Dr. Holtrop -- that is, an average increase of



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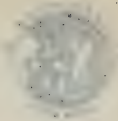
COMMISSIONER GIBSON: Is that a reference

to the fact that is, an average increase of



1 2½ per cent per year?

2 DR. HOLTROP: I do not consider it in the
3 long run as a tolerable situation at all, but I think
4 under the conditions it was an unavoidable situation.
5 I think that in the process of international adaptation
6 those kinds of periods may occur. I do not consider
7 it a tolerable situation in the long run because it would
8 imply wage increases in the long run of at least 5 per
9 cent a year. There are differences of opinion on this
10 matter, but at the present time an increase of about
11 2½ per cent per year per head of the population in real
12 income has been normal.



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2 already increases in real income of 4 per cent in
3 total -- $1\frac{1}{2}$ per cent being due to increases in
4 population and, therefore, $2\frac{1}{2}$ per cent being due
5 to an increase in productivity. I would not be
6 able to foresee whether in the long run we can
7 expect that to continue, ~~but~~ were it to continue,
8 on top of that you would have to have a $2\frac{1}{2}$ per cent
9 price increase, which would mean you would have to
10 have about a 5 per cent wage increase a year. I
11 cannot believe in the possibility of maintaining
12 the equilibrium in your whole economy on the basis
13 of that high yearly wage increase, because it means
14 you also cannot forget the university professors
15 and the other people, but no government thinks in
16 those terms, so your whole system of ~~prices and~~
17 wages experiences a terrible tension, ~~therefore~~
18 you ~~are~~ to continually have that increase. It
19 also brings up the problem of whether your banking
20 system can inflate that high in the long run, so I
21 hope it would be possible to have stable ~~prices and~~
22 indeed, an increase in real income that would be
23 ~~matched~~ by an increase in nominal incomes.

24 THE CHAIRMAN: Dr. Holtrop, is it
25 possible to measure the increase in productivity
26 of a university professor?

27 DR. HOLTROP: No. University professors
28 and all functionaries of government have a productivity
29 that is measured by their income. The national
30 accounts do not allow us to do it differently.



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1 THE CHAIRMAN: You mentioned the service
2 industries as being responsible for a considerable
3 proportion of the increase in wages.

4 DR. HOLTROP: No, in the cost of living.

5 THE CHAIRMAN: Yes, in the cost of living.

6 Well, how would you measure the productivity of
7 persons in the service industries? As I recollect
8 the situation, some years ago in the service industries
9 they were, on the whole, very poorly paid -- poorly
10 paid, perhaps, largely because of the supply and
11 demand situation for that sort of labour, they were
12 plentiful. More recently they have become less
13 plentiful, and they hold out for higher wages.

14 Perhaps they are not doing more per dollar, or per
15 whatever the currency may be, but there may not be
16 an increase in productivity relatively to what they
17 did a few years ago. But is it not inevitable
18 that when the demand and supply situation changes
19 for labour of that kind that wages will rise?

20 DR. HOLTROP: No, I would not be able
21 to give you the answer to that question, because
22 if I asked the same question at home I would turn
23 to my statisticians and they would not be able to
24 answer, and then I would ask them to go to the Central Bureau
25 of Statistics, to find out how, in a special case, they make
26 the split-up between volume and price. That
27 is easy to do in the case of manufactured products
28 that continue in the same character. However, if
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1 and quantity, then you have to give up -- as you cannot
2 do in the case of government functionaries. It is
3 a question of statistical technique, where I would
4 not be able to give you the exact reply. I think
5 there are cases also in service industries where
6 it is possible to distinguish between quantity and
7 price.

8 THE CHAIRMAN: It may be that the wages
9 of the service industries have substantially increased
10 over that period, but it does it also apply to the
11 wages in agriculture and other industries?

12 DR. HOLTROP: Yes, in our country.
13 In our country the wage level is rather homogeneous,
14 but that is exceptional, because we are such a
15 small country, and it has, moreover, been the policy
16 of labour and government to make wages homogeneous.

17 THE CHAIRMAN: But there has been an
18 increase in productivity of agriculture, from what
19 you have said?

20 DR. HOLTROP: Yes.

21 THE CHAIRMAN: There are fewer but they are
22 producing more?

23 DR. HOLTROP: Yes.

24 THE CHAIRMAN: It may be so in industry
25 generally, but with the service industries, how do
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1 account are able to make the distinction between
2 quantity and price; and if they cannot, you cannot
3 measure it.

4 THE CHAIRMAN: The price for farm
5 products in the Netherlands, have they risen in
6 comparison to the rise in agricultural wages?

7 DR. HOLTROP: "Foreign" products? Is
8 that what you said?

9 THE CHAIRMAN: "Farm" products --
10 agriculture.

11 DR. HOLTROP: Yes, in a way they have.
12 That is a difficult subject again, because part of
13 the farm produce is not a free price, and part is.
14 We have also a system of agricultural price support
15 for five main farm products, where indeed the
16 government will allow the price to be raised.
17 For the rest, prices are free, and may or may not
18 go up. For example, the price of fruit and
19 vegetables is completely free.

20 THE CHAIRMAN: But generally?

21 DR. HOLTROP: Generally, they have been
22 playing a big role in the increase of prices.
23 Farm products have risen much more than industrial
24 products internally, within the country.

25 THE CHAIRMAN: Have industrial products
26 risen very much?

27 DR. HOLTROP: No, they have been
28 remarkably stable. They have some, but not very
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1 1953, because you may remember that Holland joined
2 with the devaluation of Britain in 1949, and that
3 was a very big devaluation, one which was only
4 worked off in prices in the course of the next
5 few years. So that the period between 1949 and,
6 let us say, 1953 has been very much under the influence
7 of devaluation also, so that it was not a period of
8 stability.

9 COMMISSIONER GIBSON: Going back to the
10 question of what is a tolerable price increase,
11 you answered by saying that in the future you
12 hope there would not be any price increase. In
13 view of the fact you mentioned services which are to a
14 large degree labour and wages, will increase with
15 rising productivity in other sections of the economy,
16 pushing up wages for services, even if productivity
17 is not rising there, is this a possible eventuality?
18 This implies that the price of goods will have to
19 decline, but the price of services will probably go
20 up.

21 DR. HOLTROP: Certainly, in my opinion,
22 the price of industrial goods where the increase in
23 productivity exceeds the average, ought to go down and
24 create a compensation there for the increase in the services.
25 Unless you look upon it from the national point of view,
26 it is not a matter of arithmetic, there you have to more
27 or less adapt yourself to an international price
28 level and build up your own price level on the basis
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1 again that is a declaration of an ideal you would
2 not expect to be able, at any rate, to influence
3 yourself to a very large extent; that will be the
4 result of international conditions. I can only
5 say that if you do not get near to those conditions
6 you will be faced again in the long run with problems
7 of international parities, because you will come
8 to the point where some countries will be reluctant
9 to follow that international price increase, and
10 where you get tensions in the field of parities.

11 COMMISSIONER GIBSON: Do you feel that
12 the general world price outlook is still strongly
13 inflationary?

14 DR. HOLTROP: No. I think that in the
15 last four years it has been remarkably stable.

16 COMMISSIONER GIBSON: Would you agree
17 with Per Jacobsen in his view that the great
18 inflationary forces have pretty much diminished
19 now?

20 DR. HOLTROP: I would agree with him
21 that it is a fact that international price levels
22 in the last four years have been satisfactorily
23 stable.

24 COMMISSIONER GIBSON: Let us put it
25 another way: do you think that the outlook for
26 the next decade is less inflationary than the last?

27 DR. HOLTROP: I would expect that
28 also to be the case, because I think the last
29 decade has been under the influence of conditions
30 established in the after-war years, and the after-



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1 war excess liquidity. But I also feel it is a constant
2 fight and, therefore, you cannot predict too definitely
3 because it will all be the outcome of policies to
4 be followed by governments. Nobody knows what
5 policies governments are going to follow -- at
6 any rate, not that surely.

7 COMMISSIONER GIBSON: It is a change
8 in concept quite a bit, because we have talked
9 about the problems of inflation and the rise in
10 prices.

11 DR. HOLTROP: Yes.

12 COMMISSIONER GIBSON: What about the
13 conflict between your two-fold objective of
14 maintaining internal and external value of the
15 currency unit when conditions at home are de-
16flationary, when you have unemployment and when
17 your exchange rate is embarrassingly high?
18 This is the position we found ourselves in a little
19 while ago. I take it that it is not a position
20 you have been in in Holland, from your memorandum.
21 Would you care to say anything about how far you
22 think a country ought to defend the value of its
23 currency?

24 DR. HOLTROP: In a general way, I would
25 be willing to say this about it: I think it would
26 be a question of proper analysis of the situation --
27 with all the difficulties of that type of analysis.
28 But you can come into conflict as a consequence
29 of your own policies. You may come into a
30 situation, if you have followed yourself inflationary



war excess liquidity. But I also feel it is a constant
fight and, therefore, you cannot predict too definitely
because it will all be the outcome of policies to
be followed by governments. Nobody knows what
policies governments are going to follow -- at
any rate, not that early.

COMMISSIONER GIBSON: It is a change

in concept quite a bit, because we have talked
about the problems of inflation and the rise in

DR. HOLTROP: Yes.

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1 policies in a neutral world -- you are bound to find
2 yourself in a balance of payment deficit, and you
3 may have to ask, "What about the choice between
4 internal and external stability?". In the early
5 stages of that situation it is quite clear that
6 external stability should prevail, and that you
7 should stop following inflationary policies. It
8 is also possible, we have known that in the thirties,
9 that your balance of payment deficit is not caused
10 by your own inflation but by world deflation.
11 That is very hard, because that condition ought
12 to be fought by monetary policies in the rest of
13 the world, but you cannot decide about those policies.
14 Therefore, the choice between using the change in the
15 rate or not is a different one than in the case
16 where you have the choice of your own monetary
17 policies that might control the situation. This
18 has been the dilemma in which several countries
19 found themselves in the thirties. We ourselves,
20 at one stage, had to decide to devalue the currency
21 because in that deflationary world we could not
22 possibly, by our own policies, maintain the parity
23 without continuing to deflate within the country
24 also.

25 Now, the other case is that the disparity
26 which comes out in your balance of payment situation
27 is not at all the consequence of monetary conditions,
28 but is a consequence of shifts in international demand.
29 That is a completely different situation
30 of course, and under those circumstances I can very



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1 well see the possibility of conditions where a country
2 comes to the conclusion that international demand
3 has made shifts which are long-run and which are
4 not expected to change very much, and as a conse-
5 quence it is left with a rate of exchange that
6 cannot be expected to be an equilibrium rate in
7 the future. Under those conditions it might be
8 better to change the rate than to deflate, in
9 order to get into equilibrium again. The same
10 holds true of the reverse, as in the case of
11 Holland and Germany two years ago. We only
12 followed Germany; we, as a small country, would
13 not have taken this decision/above. But, there again,
14 a country can be faced with the dilemma of allowing
15 a further internal price-wage inflation, or perhaps
16 rather change the rates and have it done with that
17 change of rate. Theoretically, these problems
18 can come up, and in the future countries can be
19 faced with this type of decision. We know, on
20 the other hand, through international experience,
21 that there always should be a certain bias for
22 maintaining the rate, because a change in rate
23 is, after all, a very painful procedure and also
24 causes, or may cause, all sorts of disturbances.
25 However, I do not think you can give a general
26 answer to that question. Every country, then,
27 has to judge its own situation and to know what
28 it can do with one instrument, or what it might
29 do with the other instrument, and has to choose
30 between the two.

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Toronto, Ontario

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1 COMMISSIONER GIBSON: Thank you
2 very much. I have no further questions.

3
4 --- Short recess.



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1 COMMISSIONER MACKINTOSH: Dr. Holtrop, I
2 would like to ask you some rather elementary questions
3 to clear up my understanding of your techniques of
4 monetary policy. I take it from the memorandum which
5 you have submitted that discount policy is not a
6 particularly strong item in your list of techniques.
7 You mention the banks at times are not discounting with
8 the central bank: does the central bank at times force
9 the banks into central bank credit? The Federal
10 Reserve in America has done this. The Bank of England
11 used to bring the market in.

12 DR. HOLTROP: No. In that respect Holland
13 is a somewhat difficult example for other countries
14 because of the special conditions prevailing in Holland
15 which, in a way, are comparable to conditions prevailing
16 in a small country like Switzerland. The discount rate
17 is not a rate that is usually effective in the sense
18 of controlling market rates, and it is not effective because the
19 banks normally do not need central bank credit.

20 The cause of these conditions which prevail
21 also in some other small countries -- but Holland and
22 Switzerland are good examples -- is that the foreign
23 exchange holdings of the central bank, the reserves of
24 the country, are normally quite a bit larger than the
25 monetary circulation in the sense of the bank note
26 circulation. So, if you take the balance sheet of the
27 central bank and also take into consideration we do not
28 hold an equalization fund asset -- it is the central bank
29 that holds the foreign exchange reserves -- you will find
30 on the one hand gold and foreign exchange, and on the



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exchange holdings of the central bank, the reserves of

the country, are normally quite a bit lower than the

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circulation. So, if you take the balance sheet of the

central bank and also take into consideration we do not

take into account the gold and foreign exchange, and on the

other side you have the monetary circulation in the sense of the

bank note circulation, and you see that the monetary circulation



1 other hand you find the bank note circulation which is
2 lower, and then you find on the liabilities side
3 some government deposits and some deposits by the
4 banking community. That is the whole story of
5 the balance sheet of the central bank. The private
6 banks, the market, does not play a role in that
7 balance sheet any more. The Bank does not play
8 an active role in the market except that it has also
9 a small portfolio of short-term government paper with
10 which it can operate on the market. So, there is a
11 possibility of open market policies, but not to a very
12 large extent.

13 This condition means that the market rate
14 on the short-term market is more or less conditioned
15 by the international situation also, because the
16 banks have the choice of investing in the home market or
17 in the foreign money market and then cover their exchange
18 risk. They will do either one or the other as circumstances
19 permit and as the rates are. It means that the market
20 rate, as distinguished from the formal discount rate,
21 is more or less conditioned by the situation in other
22 countries, by the market rates prevailing, elsewhere,
23 and by the conditions on the market for foreign
24 exchange, because banks will not take exchange
25 risks as a rule. So, if a Dutch bank chooses to
26 hold part of its liquidity either externally or
27 internally -- London or New York, or wherever the
28 market is -- it will cover the exchange risk and
29 therefore it has to deduct from the gross
30 interest the cost of the swap



1 It is in that way this market rate is fixed. The market
2 rate is the consequence of a situation of a rather
3 liquid situation or the situation in a country itself,
4 because the foreign exchange reserves are, relative
5 to the bank-note circulation, high. They are not by
6 themselves high. Our foreign exchange reserves do not
7 exceed four months imports. If I remember correctly,
8 it is even a figure which is much lower than yours.
9 Your imports and exports are high, and if I remember
10 rightly yours used to be on six months exports -- there
11 used to be \$2 billion.

12 COMMISSIONER MACKINTOSH: They are now.

13 DR. HOLTROP: Yes. So, the four months by
14 itself is not high, but that is the normal situation.
15 Under conditions of balance of payments deficits you
16 will find the banks lose deposits because deposits are
17 being used by the private sector of the economy to pay
18 for the excess of imports. So, the liquidity of the
19 banks in the case of a balance of payments deficit is
20 rather quickly reduced, and that may create a situation
21 in which the bank has to turn to the central bank to
22 be accommodated by the central bank.

23 It was a condition which was quite naturally
24 caused in, for example, 1956-1957, the last time we had
25 a real big balance of payment deficit, and conditions
26 had to be tightened on the market. So, in that year
27 it was possible to increase the bank rate and have it
28 completely effective. The banks had to pay the higher
29 rate and it worked all through the market.

30 There are other situations in which we have



It is in that way this market rate is fixed. The market rate is the consequence of a situation of a rather liquid situation or the situation in a country itself, to the bank-note circulation, high. They are not by themselves high. Our foreign exchange reserves do not exceed four months imports. If I remember correctly, it is even a figure which is much lower than yours. Your imports and exports are high, and if I remember rightly yours used to be on six months exports -- there

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DR. HOLLAND: Yes. So, the four months by itself is not high, but that is the normal situation. Under conditions of balance of payments deficits you will find the banks lose deposits because deposits are being used by the private sector of the economy to pay for the excess of imports. So, the liquidity of the banks in the case of a balance of payments deficit is rather quickly reduced, and that may create a situation in which the bank has to turn to the central bank to be accommodated by the central bank.

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1 tried, you might say, tricks. We have artificially
2 created conditions in which the bank rate would work
3 that way. We did that, for example, in the Korean
4 crisis. In the Korean crisis the banks also were still
5 very liquid because they held a vast amount, or a large
6 amount, of short-term government paper and could easily,
7 when the balance of payment deficit led to a withdrawal
8 of funds from the banks, have financed themselves by
9 letting the short-term government paper run off, and
10 then it would have been the government in trouble and
11 not the banks. The government would have to turn to
12 the market and create conditions where the discount
13 rate would also have to become effective.

14 At that moment we made special rulings: we
15 agreed with the banks, and they took it upon themselves
16 not to liquidate their short-term government holdings,
17 but in case of either exceeding a certain ceiling of
18 credit expansion or going down below a certain level
19 of liquidity they would borrow from the bank for the
20 excess. So, by convention we forced the banks to borrow
21 from the Bank to make the rate effective.

22 So, there are situations in which, by artificial
23 means, we have made the rate effective. There are
24 situations, but only in cases of strong balance of
25 payments deficits, where the rate becomes effective,
26 but under the normal conditions the rate is not
27 effective in the sense it controls the market rate.
28 It does, however, yet have an influence which is of
29 some importance, because the rates the commercial banks
30 charge for their loans to clients is mostly based on the



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1 Bank rate. They will have a rate, for example, of
2 $1\frac{1}{2}$ per cent above the bank rate with a minimum of say
3 $4\frac{1}{2}$ per cent. So, that means if the bank rate is increased
4 beyond 3 per cent they will increase the rate charged
5 to the customers. At the present time, since 1961
6 as a matter of fact, when we increased the bank rate
7 because we considered it necessary from the point of
8 view of monetary policy to exert a certain restrictive
9 influence, we have increased the bank rate to 4 per cent,
10 and it had been $2\frac{3}{4}$ per cent in the period before that.
11 We increased it in two steps to 4 per cent and this led
12 to an increase also in the cost of bank loans to the
13 public.

14 So, in that indirect way it became effective.
15 However, the market rate is fluctuating at the present
16 time. It has been ~~seven-eighths of~~ one per cent for
17 a short period, and it has been up to 2 per cent, but
18 it has never in the last two years gone much higher
19 than that. In the last two years it has been fluctuating,
20 you might say, between one and, I think, $2\frac{1}{2}$ per cent.
21 The market rate is well below the bank rate.

22 COMMISSIONER MACKINTOSH: You have already
23 indicated that open market policy has a pretty small
24 role in your operations?

25 DR. HOLTROP: Yes.

26 COMMISSIONER MACKINTOSH: Would I be right
27 in concluding that your major weapon is this variation
28 of the cash reserves?

29 DR. HOLTROP: No, it would not be fair to put
30 it that way because our cash reserve system is actually

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28 Bank rate. They will have a minimum of say



1 based on a gentlemen's agreement with the banks, and
2 the basic idea of a gentlemen's agreement was not that
3 we should use the cash reserves as a method of
4 constraining the banks, but that we should use it as
5 an additional means of open market policy. You really
6 have to look upon our cash reserve system as an
7 additional form of open market policy. We actually do
8 it this way, that at a certain moment -- and there again
9 you have to think of the balance of payments -- if our
10 balance of payments is in surplus it means we get an
11 influx of foreign exchange, and we take over the foreign
12 exchange from the banks, and the banks get their
13 liquidity, and they have to place these funds on the
14 foreign market, if they can, but then, they don't sell
15 the foreign exchange to us. However, if there is no
16 opportunity to place it on the foreign market they
17 have to put it on the home market, and we can do two
18 things: we may sell short-term paper out of our own
19 portfolio to give the banks the opportunity of investing
20 the surplus, and at the same time we can increase the
21 cash ratio to absorb the other part. The reverse will
22 take place when we have temporarily a period of balance
23 of payments deficit. Then again, we will give the banks
24 back some of their liquidity by lowering the cash reserve
25 ratio, and at the same time buying from them some short-
26 term paper out of their portfolio. It is not only the
27 balance of payments that has to be taken into consider-
28 ation; it is also the fluctuation in the account of
29 the treasury. The treasury only keeps its account with
30 the central bank, not with the private banks.

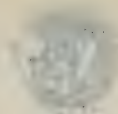
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1 I think in your country they can also hold deposits
2 with private banks. The treasury can be seasonably
3 in surplus. We have tax payments especially between
4 September and December when the treasury runs up a balance
5 with the Bank, and the consequence is that the money
6 market gets tighter, and then again we use both open
7 market policy and cash reserve ratio to give back
8 some liquidity to the banking system.

9 COMMISSIONER MACKINTOSH: I am not quite clear
10 in what respect your agreement with the banks limits
11 its policy. Is it that you undertake to use both so
12 that the private banks' earning power is not seriously
13 prejudiced?

14 DR. HOLTROP: There is something to that,
15 but it is also a matter of quantity. Our open market
16 portfolio -- you might say the amount of credit which
17 we still give to the government, has gradually gone down
18 to an immense degree. Just after the war we started
19 with an open market portfolio of some three billion
20 guilders. That was the result of the war inflation,
21 really, which we had gone through, and the government
22 has gradually paid back its debt to the bank. So that, our
23 open market portfolio has gradually decreased, and our
24 foreign exchange reserves have gradually increased.
25 So, in our balance sheet of the bank the open market
26 portfolio has been replaced by foreign exchange reserves.
27 The small open market portfolio, therefore, limits the
28 opportunity of using open market policy for the central bank
29 and with a portfolio of only a few hundred million guilders
30 we cannot exert a very strong influence on the market,



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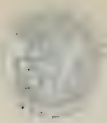
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1 and therefore need an additional means. We had to agree
2 with the banks to get that: we made a gentlemen's
3 agreement to get that result, and that gentlemen's
4 agreement took also into consideration the interest of
5 the banks themselves, and therefore led to that situation
6 in which we agreed we should, about 50/50, make use of
7 both means in case of need.

8 You may ask as a consequence, what, then,
9 is our restraining policy? What means do we have to
10 exert an influence on the banks? The answer is that
11 we have to make use of quantitative measures. We have
12 to agree with the banks on certain ceilings for their
13 credit expansion, because the normal market means cannot
14 very well be used in a country where the central bank
15 keeps the foreign exchange reserves, and where the
16 foreign exchange reserves then exceed the bank-note
17 circulation. You will find in countries where those
18 conditions prevail that the central bank has difficulties
19 in controlling the money market, and that these are countries
20 where usually the money market rates are low. Switzerland
21 and Holland are the big examples there.

22 COMMISSIONER MACKINTOSH: Yes. What you say
23 with respect to agreements with the bank was what I
24 wanted to raise next. My recollection is that while
25 you have power to give directives you have not used it,
26 but rather you have preferred to make agreements with
27 the banks?



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2 all the time to get that. We made a preliminary
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28 the banks?



1 DR. HOLTROP: The Bank Act and the Act of
2 control of the credit system gives us certain powers,
3 but it makes those powers conditional. That is to
4 say, we either have to try to get agreement with the
5 representative organizations of the banks about
6 the measures we take, and then these measures are
7 final and binding with the individual banks, or,
8 if we don't get agreement with the banks, then we
9 can act on our own with approval of the minister of
10 finance, but the measures we take have then to be approved
11 by parliament, they have to be introduced within
12 three months to parliament for approval, so there
13 is rather a strong check in our system on the
14 possibilities of strong measures of central bank
15 policy.

16 Now, the powers we have go rather far
17 because we can declare certain ceilings, we can
18 make rules about the relationship between liquid
19 holdings and liabilities, we can go rather far in that
20 respect if for reasons of monetary policy we think
21 it is necessary. But on the other hand, the
22 interest of the banks and the interest of the community is
23 protected by this; either we have to do these things
24 after consultation and agreement with the banks or
25 we have to do it with explicit approval of the minister
26 of finance, who then has to turn to parliament to
27 get parliamentary approval of that.

28 COMMISSIONER LEMAN: In such a case
29 would it be normal for the governor himself to
30 appear before parliament to defend it?



DR. HOUSTON: The Bank Act and the Act of

control of the credit system gives us certain powers,

but it makes those powers conditional. That is to

say, we either have to try to get agreement with the

representative organizations of the banks about

the measures we take, and then these measures are

final and binding with the individual banks or,

if we don't get agreement with the banks, then we

can act on our own with approval of the minister of

finance, but the measures we take have then to be approved

by parliament, they have to be introduced within

three months to parliament for approval, so there

is rather a strong check in our system on the

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DR. HOUSTON: Now, the Bank Act is passed by

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1 DR. HOLTROP: No, we don't have public
2 appearances before parliament. We haven't your
3 system of parliamentary committees; parliamentary
4 committees don't hold hearings under our system
5 of government so there has never been an occasion
6 where the president of the bank gets in touch with
7 parliament; it is the minister of finance who is
8 responsible to parliament.

9 COMMISSIONER GIBSON: Have you ever
10 taken such measures to parliament?

11 DR. HOLTROP: No. It is the same thing
12 as with the directive, this has never been used,
13 and it is again a part of the system I think we
14 developed in Holland where you have in a way a
15 big stick in the background, the directive in
16 the relationship between the government and the
17 central bank, the measures to be taken by the
18 central bank with the approval of the minister of
19 finance in the relationship between the central
20 bank and the banking system, which guarantees, in a
21 way, that the consultations will lead to a result.
22 I think if there wasn't that big stick behind that
23 it would be very difficult to agree with the banks
24 on measures which would, after all, be limiting on
25 their activity. It is very difficult for them as
26 private institutions to take the same public view
27 as the central bank. On the other hand, knowing
28 that it is possible that stronger measures be taken,
29 they will try to come to an agreement with the bank,
30 and that has worked out that way.



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1 That is the result of the latest credit
2 control Act which is the Act of 1954, and under the
3 older law we had not got this system; there we had
4 a system that the Bank had to have the approval of
5 the minister of finance to take certain measures,
6 and the banks had no say in it. The banks were
7 in opposition to that system; they had always taken
8 the position that these kind of measures could be
9 made by a gentlemen's agreement, and that it was possible
10 to make them by gentlemen's agreement. Under the
11 old law we haven't made use of the legal powers,
12 but we did develop certain gentlemen's agreements
13 with the banks, and as a consequence of that we have
14 also come to a change of law. So, in 1954, the
15 law was changed in the direction of the wishes of
16 the banks, and that in a way the system of the
17 gentlemen's agreement was introduced as the first
18 stage of monetary policy, and behind that you have
19 the possibility of stronger measures, but I must
20 make it clear that this all applies, of course, only
21 to special powers of directive which the bank has.

22 If by natural causes the bank rate
23 becomes effective, it leaves the bank free to give
24 or not to give credit to certain banks, and it makes
25 its own conditions when it gives credit to the banks.
26 The special powers of directive are necessary in those
27 conditions that the banks are not really dependent
28 on the central bank for borrowing money, because then
29 the bank might find itself up in the air in its
30 possibilities of sufficiently influencing the banking



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1 system.

2 COMMISSIONER BROWN: It is more than just
3 moral suasion?

4 DR. HOLTROP: It is definitely more
5 than moral suasion. We have tried moral suasion
6 also and we have also had other experiences. When
7 we were still at the first Act, which was rather a
8 cumbersome thing, we tried also by moral suasion
9 to influence the banks. The trouble is you never
10 know how far it works. The banks will be open to
11 it and you believe, of course, that it has a
12 certain influence, but you are always in doubt as
13 to how much. Moral suasion can't be put in
14 quantitative terms, of course, and the powers we now
15 have can be put in quantitative terms. For example,
16 at the time we actually apply rates where the banks
17 are allowed to increase the total of their loans by --
18 at the present moment we have a figure of $\frac{1}{2}$ per cent
19 per month, and if they exceed that figure they have
20 to make special deposits which make it unprofitable
21 for them to exceed those limits, so they try not to
22 exceed them by any large extent. As a consequence
23 you will have a quantitative measure and you have the
24 feeling that the result of the measure is what you
25 wanted to have.

26 COMMISSIONER BROWN: For how long a period
27 has this one per cent per month been used?

28 DR. HOLTROP: It is $\frac{1}{2}$ per cent per month.
29 Only since the beginning of this year; the
30 application of this type of control was only started



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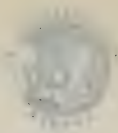
1 in July, 1961, so it is only somewhat more than a year
2 that we now have this measure of quantitative limitation
3 of the expansion of the credit of the banks.

4 COMMISSIONER BROWN: I wonder if you
5 would also describe for us in some detail how you
6 measure the reserves that they are to hold; what
7 time lag is there between the definition of their
8 requirements and what they have to have at all times?

9 DR. HOLTROP: The basis of the figures
10 already used is a three months' moving average, so
11 the $\frac{1}{2}$ per cent applies to the three months' moving
12 average, and therefore let us say the June figure
13 with which we work is the average of the months
14 of April, May and June, and this is referred to a
15 basic period -- the basic period presently is the
16 fourth quarter of 1960 -- and this is the basis on
17 which the increase in loans is measured the
18 month in which they have to make the special deposits, if
19 they are in excess of the norm fixed by the bank,
20 is the month directly after the figures have become
21 available, so that means that the figures for the
22 month of June will become available at the end of
23 the month of July, and then in the month of August
24 they will have to make the special deposits which
25 will compensate for the excess in the month of June.

26 COMMISSIONER BROWN: It is a two and
27 one-half month lag, if you take the average?

28 DR. HOLTROP: If you take the average,
29 it is a two and one-half month lag but the average
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COMMISSIONER: I wonder if you

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COMMISSIONER: Now, if it is a two and

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DR. HOLTON: If you have the average

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1 is, of course, the way to keep out a little bit the
2 excess fluctuations and you might say that it is
3 one and a half months also; it is just as you take
4 it, but it is true because of this moving average the
5 actual figure of June will only influence the
6 calculating basis of the month of June for one-third.

7 COMMISSIONER BROWN: The other thing
8 was you mentioned that the bank charges to their
9 customers a rate of $1\frac{1}{2}$ per cent in excess of the
10 banking rate. Is this by custom? Is there any
11 statutory limit?

12 DR. HOLTROP: There is no statute
13 whatever and I would say it is not an absolute rule;
14 a large part of the loans made by the banks are
15 however covered by this custom.

16 COMMISSIONER BROWN: It is the prime rate?

17 DR. HOLTROP: You might call it that. We
18 don't use the notion of prime rate.. All the rates
19 are quite competitive, and in a way nobody knows
20 what the most favourable rate is that the bank will
21 charge to the most favoured customer.

22 COMMISSIONER BROWN: Would you care to
23 comment on the theory of a legislative ceiling
24 on bank charges?

25 DR. HOLTROP: I must say that our
26 experience with no legislative ceilings whatever
27 has been favourable, and from what I have observed in the
28 experience of other central banks and other banking
29 systems I have tended to think that all these sorts
30 of rules are dangerous in a way because you come



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40. experience of other central banks and other banking
41. systems I have tended to think that all these sorts
42. of rules are dangerous in a way because you come



1 to points where the rule prevents you from doing the
2 right thing.

3 It is all very nice to say that a
4 certain rate of interest should not be exceeded
5 either on the debit or the credit side at a certain
6 moment, but nevertheless you can get into conditions,
7 to take the example of the United Kingdom, that at a
8 certain moment you really want to have strong
9 influence, and you may have a bank rate of 7 per cent
10 and the whole purpose of the bank rate is that it is
11 charged to the customer. If it is not charged to
12 the customer, you can't imagine that it has an
13 influence on spending habits and under these cir-
14 cumstances -- which are exceptional, admittedly, --
15 you may say that it is perfectly all right if they have
16 to pay 8 or 9 per cent on a bank loan, as it is the
17 idea that this could reduce the demand for bank
18 loans.

19 On the other hand, we have a competitive
20 banking system, I must admit that, and there is
21 complete freedom of action by the banks on high
22 or low rates. We have no statutory limits as in
23 the United States, for example, for credit interest
24 which the bank pays. It is a highly competitive
25 business and the banks can just pay for the deposits
26 what they want. There is, of course, a certain
27 tendency for all the normal depositors to get to a
28 certain normal figure, but there again smaller banks
29 will pay somewhat higher rates. Banks that are in
30 a situation that they need more deposits will pay a
somewhat higher rate than other banks, and we don't

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1 find that that is disturbing at all. So, our
2 experience with our freedom has been favourable,
3 I would say.

4 COMMISSIONER BROWN: You increase bank
5 rates and therefore there is an implication that all
6 charges to customers are going to be increased.
7 You also mentioned that it was very competitive.
8 Does this apply in some cases where perhaps these
9 increases don't go through?

10 DR. HOLTROP: They may not come through;
11 we urge banks as much as possible to pass them
12 on, so there is a tendency to ask the banks to
13 let the bank rate work itself out. This is true
14 also in the other cases when we reduce the rates;
15 they are, however, free and we don't control them.

16 COMMISSIONER BROWN: How about other bank
17 charges? That is, the banks charge you for other
18 services?

19 DR. HOLTROP: Yes.

20 COMMISSIONER BROWN: Are these more or
21 less standard or ---

22 DR. HOLTROP: There are certain banking
23 charges where the banks have agreements among one
24 another.

25 COMMISSIONER BROWN: And this is permitted?

26 DR. HOLTROP: Yes, this is permitted.

27 COMMISSIONER BROWN: There is one further
28 question which I would like to ask on this, and this
29 is one of our problems; what is the definition of a bank?
30



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COMMISSIONER BROWN: Now about other bank
contracts? What is the bank charge you for other
services?

DR. HOLBROOK: Yes.

COMMISSIONER BROWN: Are there more or

less standard or --

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COMMISSIONER BROWN: There is one further
question which I would like to ask on this, and this
is one of our problems; what is the definition of a



1 I understand you have such a definition by statute?

2 DR. HOLTROP: Yes, we have by statute, we
3 have a definition and we call a bank every institution
4 that makes it its business to receive, to a major
5 extent, bank deposits and to make loans; that is
6 our definition of a bank. Everybody who takes
7 deposits and makes loans is a bank and comes under
8 our control and is registered as a bank and is
9 controlled by the central bank and comes under the
10 whole legislation.

11 COMMISSIONER MACKINTOSH: How do you
12 define to a major extent how much of a bank they
13 have to be to be a bank?

14 DR. HOLTROP: You get to a fine point
15 because we have a slightly different definition on
16 the active side and on the passive side. Let us
17 say that there are no statutory limits; it is left
18 to the Netherlands bank to decide how it handles
19 it and we do handle it this way. Taking the deposits,
20 we have fixed -- a rather low quantitative limit;
21 we say, I think it is, when you have 100,000 guilders
22 on deposit that it is all right. On the other hand,
23 in making loans, we look at the proportion to the other
24 parts of their business. So, we say: if you are in
25 the business of making loans as your normal type
26 of business, then you are completely a bank.

27 If you take some small deposits or
28 even accept that low limit of 100,000 guilders and
29 only sometimes make a loan, but in the major part of your
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1 business you are not making loans, then we should say
2 no, you are not a bank. This is a matter of judgment
3 by the central bank.

4 COMMISSIONER MACKINTOSH: They must both
5 make loans and deposits?

6 DR. HOLTROP: Yes.

7 COMMISSIONER MACKINTOSH: Then, in fact,
8 you don't say that people, or institutions which
9 have only a small amount on deposit, are not banks,
10 but really you say they are too small for you to
11 bring them into the system?

12 DR. HOLTROP: Yes, they are too small
13 for us to register when you are below that limit
14 and it is not worthwhile to be registered even if
15 you act as a bank. Everybody can look in the
16 registry to see if you are registered. Then, on
17 the other hand, therefore we say if you take
18 deposits and very exceptionally make a loan, we
19 for that reason don't consider you a bank, but if
20 you make it your business of making loans, then we
21 do.

22 COMMISSIONER GIBSON: How do you define
23 deposits, do you include time deposits?

24 DR. HOLTROP: Yes, we do. The difference
25 between -- you get me into quite legalistic points
26 here - you have, of course, to distinguish between
27 (a) a private loan and (b) a deposit. But a deposit
28 with us is a thing that either can be claimed back
29 on demand or after a fixed time limit, and which is
30 also publicly announced. You are willing to take

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1 deposits, so it is also a question of public announce-
2 ment. If you don't publicly announce you are willing
3 to take deposits, but you get loans from some place
4 where it could be a question of whether it is legally
5 a loan or a deposit, then we will say this organization
6 doesn't announce itself as taking deposits, and therefore
7 is not a bank.

8 COMMISSIONER GIBSON: What if you are willing
9 to sell fixed term paper?

10 DR. HOLTROP: Fixed term paper wouldn't
11 be a deposit under our system, and institutions that
12 sell fixed paper would not be considered to take
13 deposits. I assume it might create problems if there
14 were institutions of that kind, but there are not --
15 except the municipalities, you might say, but they
16 again don't give loans. It is, I think, imaginary
17 that you could try to sell paper on the money market
18 and make loans on the other hand, but you would, if you
19 did, according to our definition, not be a bank.



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and make loans on the other hand, but you would, if you

did, according to our definition, not be a bank.



1 THE CHAIRMAN: I still fail to understand
2 the real distinction between a deposit, when it is
3 defined in the broad way you have defined it, and
4 simply lending money to an institution for a fixed
5 period. Suppose it is a time deposit to be
6 withdrawn on two weeks' notice. What is the
7 distinction from a monetary point of view between
8 that and simply lending money to an institution
9 for a fixed period?

10 DR. HOLTROP: I would say the dis-
11 tinction is in the public announcement. There is
12 also the question of whether you are in the business
13 of taking shortterm deposits from everybody, or
14 whether you are in some sort of business which you
15 finance partly by private loans from other people.
16 That is a completely different situation, and from
17 the monetary point of view I would say the man who
18 does not publicly announce himself as taking deposits
19 does not create that supposition of liquidity as does
20 the man who takes a private loan.

21 If I make a private loan to some person
22 I know very well that I am ~~no longer~~ liquid, because I
23 have invested in his business. If, on the other
24 hand, he has publicly announced that he takes
25 deposits, and creates that expectation of being
26 able to repay on demand, or to repay on the date
27 named, without any doubt then he creates a public
28 confidence which brings him into the monetary sphere,
29 because he is then apt to get the liquid reserves
30 of people temporarily into his custody. That is



THE CHAIRMAN: I still fail to understand

the real distinction between a deposit, when it is defined in the broad way you have defined it, and simply lending money to an institution for a fixed period. Suppose it is a time deposit to be withdrawn on two weeks' notice. What is the distinction from a monetary point of view between that and simply lending money to an institution for a fixed period?

DR. HOLLAND: I would say the dis-

tinction is in the public announcement. There is also the question of whether you are in the business of taking short-term deposits from everybody, or whether you are in some sort of business which you finance partly by private loans from other people. That is a completely different situation, and from the monetary point of view I would say the man who does not publicly announce himself as taking deposits does not create that supposition of liquidity as does the man who takes a private loan.

If I make a private loan to some person

I know very well that I am no longer liquid, because I have invested in his business. If, on the other hand, he has publicly announced that he takes deposits, and creates that expectation of being able to repay on demand, or to repay on the date named, without any doubt then he creates a public confidence which brings him into the monetary sphere, because he is then apt to get the liquid reserves of people temporarily into his custody. That is



1 what I feel the difference is.

2 THE CHAIRMAN: It is in the extent to
3 which he is in the business of accepting money on
4 those terms?

5 DR. HOLTROP: Yes.

6 COMMISSIONER MACKINTOSH: Would you
7 attach any importance to the question of whether
8 the deposits were transferable by cheque?

9 DR. HOLTROP: No. I know it is one
10 of the old definitions of money proper, of course,
11 and I think in the Anglo-Saxon tradition this point
12 has played a certain role because in the early times
13 money was defined as consisting only of deposits
14 subject to cheque. People have then just invented
15 deposits not subject to cheque and have said that
16 they are not money and should not be under control,
17 and therefore, generally, in Anglo-Saxon countries
18 that system has developed. Our tradition has
19 never laid very much importance on that. Perhaps this
20 is also because the cheque system has never been
21 so developed in the European countries.

22 We have gone through different techniques,
23 such as those employed in the giro system. The giro
24 system has not been employed by the banks, but the
25 central giro institutions have been government
26 institutions. There is no doubt that they create money,
27 of course. The difference between deposits subject
28 to cheque and those not subject to cheque has never
29 played an important role in the Continental
30 tradition.

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1 THE CHAIRMAN: Is it one of the conditions
2 of a bank that it must be open to accept deposits
3 from any person who wishes to make them? Suppose
4 an institution acted in a more restricted way
5 and dealt with only a group of people who were,
6 in some way, members of the institution; suppose
7 it was not doing business with the general public.
8 Would you consider that institution a bank, or have
9 you not encountered that sort of situation?

10 DR. HOLTROP: I do not know that I
11 would be able to draw on examples. The limitation
12 of membership would certainly not exempt them.
13 We have the co-operative credit banks which do not
14 limit their business to their members, but if they
15 did limit their business to their members we would
16 not consider them an exception, because if everybody
17 could become a member then they would be dealing
18 with the general public.

19 I could imagine a concern being a kind
20 of co-operative which does business only within the
21 limits of that concern. It might take deposits
22 of concern-companies only. In that case the question
23 might come up as to whether it is a bank or not,
24 as a matter of definition. If it says: "No, we
25 do not take deposits from anybody else; we take
26 them from members of our own family only", then
27 the question would indeed be whether it is a public
28 deposit or not, or whether it is really a loan.

29 THE CHAIRMAN: Have you credit unions
30 in the Netherlands?



THE CHAIRMAN: Is it one of the conditions

of a bank that it must be open to accept deposits from any person who wishes to make them? Suppose an institution acted in a more restricted way and dealt with only a group of people who were, in some way, members of the institution; suppose it was not doing business with the general public. Would you consider that institution a bank, or have you not encountered that sort of situation?

DR. HOLTBROOK: I do not know that I

would be able to draw on examples. The limitation of membership would certainly not exempt them. We have the co-operative credit banks which do not limit their business to their members, but if they did limit their business to their members we would not consider them an exception, because if everybody could become a member then they would be dealing with the general public.

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THE CHAIRMAN: Have you credit unions



1 DR. HOLTROP: Not what you call a
2 credit union.

3 THE CHAIRMAN: You understand our
4 system of credit unions, do you?

5 DR. HOLTROP: Yes, I understand credit
6 unions. That is a kind of membership system in
7 which the members make deposits and obtain the
8 right to qualify for loans as members. We do not
9 know that system.

10 THE CHAIRMAN: You have what are known
11 as co-operative banks?

12 DR. HOLTROP: We have a very important
13 co-operative agricultural banking system.

14 THE CHAIRMAN: Those are agricultural
15 banks?

16 DR. HOLTROP: Yes, but as a matter of
17 fact, they are more -- it is not exclusively
18 agricultural. In as much as the agricultural communities
19 have gradually developed industrial activities, et cetera,
20 these are also taken care of by this banking system.

21 THE CHAIRMAN: You have what you call
22 agricultural credit banks?

23 DR. HOLTROP: Yes, they call themselves
24 agricultural credit banks.

25 THE CHAIRMAN: What sort of business do
26 they do?

27 DR. HOLTROP: They do the same kind
28 of business as commercial banks with this difference,
29 that they have far earlier developed a system of
30 savings deposits. As a consequence they are great



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1 receivers of savings deposits, and they have, therefore,
2 different traditions of investment. While our
3 commercial banks have more or less followed the
4 English tradition of liquid banking -- short term
5 banking -- the agricultural credit banks have
6 followed more the tradition of long term financing
7 because on the basis of their savings deposits they
8 have always considered themselves in a position to
9 do so. They will invest in mortgages and in long
10 term bonds in the capital market to a large extent.
11 Their savings deposits will be very much higher than
12 the total of their time and current deposits or
13 slight deposits. They do have a different type of
14 business.

15 THE CHAIRMAN: But it is all part
16 of the banking business?

17 DR. HOLTROP: Yes, it is all part of
18 the banking business, and it is all controlled,
19 but in the application of rules we distinguish
20 between the two parts of their business.

21 THE CHAIRMAN: And they do business
22 with the public generally, whether they are farmers
23 or not?

24 DR. HOLTROP: They do business with
25 the local public generally.

26 THE CHAIRMAN: They are designed
27 especially to service the agricultural interests?

28 DR. HOLTROP: Yes, as co-operatives
29 their main aim is to serve the agricultural community.
30 They are based on the Raiffeisen system.



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DR. HOLTHOFER: Yes, as co-operatives



1 THE CHAIRMAN: They are co-operatives
2 in what sense?

3 DR. HOLTROP: They are co-operatives
4 in the sense that they have members, and the members
5 are liable for the obligations of the bank, so
6 part of their capital will not be paid in but will
7 consist of the liability of the members.

8 THE CHAIRMAN: But the business at
9 the bank is not confined to its members? The
10 public generally can use the agricultural credit
11 bank?

12 DR. HOLTROP: I think there are shades
13 of difference locally. You must realize that this
14 is a very pervasive system, and that there are at
15 least some 1,300 member banks each of which is a
16 legally separate unit. They are members of two
17 big systems. Their local rules might be slightly
18 different, but as a matter of principle they are
19 in the general banking business, and the local
20 carpenter or blacksmith is just as welcome, and
21 the small scale industry is just as welcome, as a
22 client, as the farmer. However, that may vary from
23 bank to bank because the strength of the system is
24 the co-operative responsibility. The committee of
25 farmers which controls the giving of the loans knows
26 everybody and knows everybody's credit standing in
27 that small community.

28 COMMISSIONER BROWN: How are their
29 reserves handled? Are they separate banks or are
30 they part of a branch system?



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1 DR. HOLTROP: They are again members of
2 a central system. There are two big central systems
3 and practically all of these credit banks are members
4 of one system or the other, and they will keep their
5 surplus reserves in the central bank.

6 COMMISSIONER BROWN: And it is the
7 central bank of the system that you look at?

8 DR. HOLTROP: Yes, it is the central
9 bank that we look at. Fundamentally, we are responsible
10 for the control of the whole system, but we exercise
11 this control through the intermediary of the central
12 bank.

13 COMMISSIONER BROWN: And it is the
14 consolidated picture that you look at?

15 DR. HOLTROP: We look at the consolidated
16 picture, yes, and they look at the individual banks.
17 They take care of the individual units.

18 COMMISSIONER MacKEEN: Have you any
19 institutions that are comparable to our savings
20 and loan companies which specialize mainly in mortgages
21 and which have no membership?

22 DR. HOLTROP: No, our mortgage banks --
23 we have a mortgage bank system but it is completely
24 different from yours because it is a professional
25 system of capital market institutions that sell a
26 special type of bond which has a special name.

27 They work on a
28 rather narrow margin. The difference may be $3/4$
29 of one per cent. They will borrow money on the
30 long term capital market, and they will give mortgages.



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1 COMMISSIONER MacKEEN: Do they accept
2 deposits?

3 DR. HOLTROP: No, they do not accept
4 deposits. If they did they would, of course, come
5 under our control.

6 COMMISSIONER MacKEEN: They do not come
7 under your control?

8 DR. HOLTROP: No, they are what we call
9 completely capital market institutions handling
10 only long-term loans. In case you are wondering
11 where the farmer gets his mortgages I should say
12 that the agricultural credit banks also do give
13 mortgage loans.

14 COMMISSIONER MacKEEN: But suppose someone
15 in the city wants to borrow on a residence, or something
16 of that sort?

17 DR. HOLTROP: Again, the answer is that
18 house ownership is not as widespread in our country
19 as it is in yours because it does not have the same
20 tax advantages as it has in this country and in
21 America. Therefore, the proportion of private
22 house ownership financed by mortgage in Holland is
23 smaller than in your country. If a person wants
24 a mortgage he would have to turn to the mortgage
25 banks or he would turn to what we call a notary.
26 A notary in Holland is in a different position
27 from that of a notary public in the United States.
28 In Holland he is a man who may manage trust funds and
29 may place part of them in mortgages, and that is
30 also a local business. He may thus act as an in-
between in placing mortgages. So, there



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from that of a notary public in the United States.

In Holland he is a man who may receive from lands and

any part of them in mortgage, and that is

the way he may find out as an in-



1 is a private market for mortgages in that way.

2 Have I made myself clear?

3 COMMISSIONER LEMAN: From where does
4 this notary get his money? Does he take deposits
5 from clients?

6 DR. HOLTROP: No, he will be only a
7 middle-man. He will be the man who takes care of
8 the administration of properties, and in that business
9 of administration he will be asked to place some
10 money on a mortgage. He will take care of that.
11 He acts as a trustee, and as a trustee he may be
12 a local middle-man in placing mortgage money also.

13 COMMISSIONER MacKEEN: Have you trust
14 companies such as we have?

15 DR. HOLTROP: We do have them, but
16 they are much less developed than on the American
17 continent.

18 COMMISSIONER MacKEEN: Would they
19 accept deposits and take back mortgages?

20 DR. HOLTROP: No, because if they
21 take deposits that will make them banks.

22 COMMISSIONER GIBSON: Going back to the
23 100 per cent deposit scheme for extra deposits
24 which you put to the banks in January, do you
25 say it is a little early to judge how well it has
26 worked? Would you care to comment a little more
27 on that? How do the banks react to it?

28 DR. HOLTROP: We have now this tradition
29 of discussing with the banks monetary policy over
30 this whole period of after-the-war development of



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1 fifteen years. We have gone through all sorts of
2 ups and downs, and we have found the banks willing
3 to accept basically the thesis that there ought to
4 be monetary policy in the country and that it must
5 be the central bank which makes the monetary policy.
6 In so far as the banking community is concerned,
7 I would say that there is that basic acceptance
8 of the existence of monetary policy, and that the
9 consequence of monetary policy is that it should
10 limit the banks in their activity.

11 On the basis of the acceptance of
12 that thesis, we have found it possible in that time
13 to agree with the banks on certain policies.

14 These policies have been different

15 because the situations under which we have lived have
16 been different. The legal powers of the bank have
17 been gradually changed. We had the first act of
18 credit control in 1948. I have mentioned it here,
19 and I think that date is correct. The second one
20 was in 1954, and I think the first one was in 1948.
21 The second act has been worked out in rather strong
22 co-operation with the banks. It was then recognized
23 that the existing act was not satisfactory, and the
24 minister of finance asked us to work out a new
25 act, and we consulted the banks very closely in this
26 field. The background of it is that after all
27 we have a system to which the banks have fundamentally
28 agreed. They have agreed to let it work. Neverthe-
29 less, under this system they will try to be as free
30



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words, after this system they will try to be as close



1 as possible, as, of course, they have their interests
2 which may be contrary to those of the central bank as
3 a result we may have some difficulties from time to
4 time in agreeing about the exact measures that should
5 be taken, and we may have differences about the timing
6 of the measures.

7 Since the new act has been in existence
8 we have had only two periods in which we, on our side,
9 thought it necessary that there should be restrictive
10 monetary policy. One period was 1956-57, and the
11 other is this present period of 1961-62. There was
12 no fundamental disagreement with the banks at all
13 about the desirability of exercising a certain restrictive
14 influence and there was, therefore, the possibility
15 of agreeing basically upon how we should do it. We
16 have agreed with the banks upon how to do it, and
17 whether it is satisfactory or not in these things
18 you have to agree on certain definitions. The types
19 of loans that are limited under the system are the
20 short-term loans. They are the current account loans.
21 They are not the long-term loans that are supposed
22 to come out of the long-term money.

23 We have to make that separation also with
24 respect to the agricultural credit banks. The
25 normal increase in their savings deposits, in our
26 opinion, do not create any monetary problem. We
27 consider those as normal capital market resources,
28 on which they can base their long-term loans.



1 We have tried to introduce this same notion
2 in the commercial banking system where the development
3 of the savings deposits is a new development. But
4 in that respect I would say that the situation is
5 not quite clarified, because we find that there are
6 some differences of opinion, or shades of opinion,
7 about the exact charzcter of the savings deposits
8 which these banks get. There is a difference of
9 opinion as to whether they are real savings deposits
10 or whether they are not.



1. The first thing I should mention is that
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3. of the savings deposits in a way that
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1 The velocity of turnover of the savings deposits of
2 the commercial banks is comparatively higher at the
3 present moment, for example, than the other savings
4 deposits. So there we are still feeling our way. We
5 are also, therefore, still feeling our way in the volume
6 of long-term credit the banks should be allowed to give.
7 Allowing for those problems of adaptation of the system
8 to the long run conditions in the future, we feel --
9 and the banks confirm this -- that the restrictive
10 influence we exert is of importance. One of the important
11 things is, I do believe, that the aim of monetary policy
12 is to have an influence on total spending. That you
13 should always keep in mind. If you have no influence
14 on total spending the only thing is to influence by the
15 rate of interest, short-term capital movement inter-
16 nationally. But that is not the fundamental monetary
17 problem. That is solving your balance of payment
18 problem on the short-term basis. The real object
19 of monetary policy should be to influence the total
20 expenditure. The possibilities of doing that in the
21 purely private field are limited. They are more
22 limited than they were in the olden times. In the
23 world of before 1914, when short-term government
24 credit was not known and so-called liquidity had
25 the form of short-term loans to the business community
26 a tight market meant, indeed, the withdrawal of loans
27 from the market and made a direct deflationary influence.
28 This is not true at the present moment because a tight
29 market at the present moment, in the first instance, squeezes
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1 more the government, or would squeeze the government
2 more than it would squeeze the private sector of the
3 economy. In so far as it squeezes the government we try
4 to escape from these consequences. We then consider
5 the monetary policy of the government as a separate item.
6 That is a government decision. You do not try to influence
7 the monetary policy of the government by the action of
8 central banks with respect to the banking system. The
9 actions of the central bank, through the banking system,
10 has the purpose of influencing either the expenditures
11 of the business community or the ways of financing by
12 the business community. The ways of financing of the
13 business community are now such that when the restrictive
14 policy is in its first stages it will force the business
15 community to look for long-term money instead of financing
16 itself by the banking community. When we tell the banks
17 it is time they should restrict their credit more, we
18 also tell them it is time they investigate what clients
19 they might send to the capital market to finance themselves
20 by long-term borrowing. If he is big enough he should
21 do this by public borrowing, or if he is smaller, by
22 borrowing from a life insurance company or other
23 institution that lends long-term money. The ultimate
24 effect on total expenditure will be gradual because
25 therefrom there will first be an influence on the long-
26 term market, and the relationship of demand and supply
27 in the long-term market will be affected. The business
28 community that finances itself in the long-term market
29 will find it will get tighter and will adapt its
30 plans because the financing opportunities are getting



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actions of the central bank, through the banking system,
has the purpose of influencing either the expenditures
of the business community or the ways of financing by
the business community. The ways of financing of the
business community are now such that when the restrictive
policy is in its first stages it will force the business
community to look for long-term money instead of financing
itself by the banking community. When we tell the banks
it is time they should restrict their credit more, we
also tell them it is time they invest more with clients
they might send to the capital market to finance themselves
by long-term borrowing. If he is big enough he should
do this by public borrowing, or it he is smaller, by
borrowing from a life insurance company or other
effect on total expenditure will be gradual because
therefrom there will first be an influence on the long-
term market, and the relationship of demand and supply
in the long-term market will be affected. The business
community that finances itself in the long-term market
will find it will get tighter and will adapt
itself because the financing opportunities are reduced



1 restricted.

2 My philosophy is really that I do believe
3 the business community fundamentally is more influenced
4 in its spending habits by its expectation of being able
5 to get financed than by the actual rate of interest. I
6 do know of the examples of house building and public
7 utility investment where whether the rate is four or five ^{per} %
8 is, of course, of great importance. But in industry my
9 own experience as an industrialist was not that we
10 ever wondered so much whether the rate would be four
11 or four and a half, but whether one would be able to
12 get the money. That was the important point. Therefore,
13 when you ask how, for example, in 1956-57, our credit
14 restrictions have worked out, definitely we have
15 forced the bank to shove off part of the market to
16 the capital market, and the capital market became
17 tight and many entrepreneurs said, "My God, I cannot
18 go on with my present expansion plan because I cannot
19 find the money." Of course, that will then influence
20 their investment decisions; and at that moment
21 that is the purpose of the whole policy, that at a
22 certain moment the investment decisions of the business
23 community have to be restricted because they happen
24 to exceed the amount of current savings. You
25 cannot replace that difference between current
26 saving and current investment by creating money without
27 getting into all the inflationary consequences of the
28 creation of money. So part of the whole thing is the
29 exertion of the restrictive influence on the banking system,
30 and the banking system pushing off that restrictive

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1 influence either by being less easy in taking on new
2 customers for borrowing or by pushing them off to
3 the capital market; the capital market then getting
4 tighter, and then, as a consequence, entrepreneurs changing
5 to adapting their investment decisions. This is in the
6 period of boom in which I think monetary policy, in the
7 restricted sense of central bank policy, has the most
8 possibilities of success.

9 Far more difficult is monetary policy in the
10 sense of central bank policy in times of recession, because
11 the characteristic of a recession is that entrepreneurs
12 will not invest whatever the rate of interest is. Then
13 you have the simile of the horse: you can lead him to
14 the pool, but you cannot force him to drink. There the
15 central bank policy, under those circumstances, cannot
16 easily have an independent influence. It is under those
17 circumstances, especially, that government monetary policy
18 ought to play a role. There, you note from my exposition,
19 that I think from the point of view of logic we must think
20 of these government policies as being part of monetary
21 policy. Those parts of government policy that are concerned
22 with financing budgetary deficits by long-term borrowing
23 or by short-term borrowing or by borrowing from the
24 banking system or with creating even surpluses, are indeed
25 cases of pure monetary policy in the general sense.
26 It is exactly the same thing again: it is again exerting
27 an influence on the total amount of expenditures. Under
28 present conditions the influence of government in that
29 field can be enormous and far more direct than the
30 influence of the central bank. There is no doubt about



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1 that. If the policy of the government is contrary to
2 the one of the central bank it is , of course, then
3 very difficult for the central bank to compensate for
4 what government policy might be doing.

5 That is, increasing expenditure in a period when it
6 should be reduced, or the reverse, reducing expenditure
7 in a period when it should be increased.

8 COMMISSIONER GIBSON: Dr. Holtrop, would you
9 care to say a word on the particular advantage of this
10 system of restriction as compared to other systems, such
11 as setting particular ratios?

12 DR. HOLTROP: I would not pretend there are
13 particular advantages. The purpose of the exercise is
14 that bank credit, the expansion of bank credit, should
15 be restrained under certain circumstances. If you can
16 use other techniques, because your market is sensitive
17 to other techniques, then use them. This technique
18 of ours, which we have to use because others would not
19 work, is a rather daring technique. I do not pretend
20 it is easy to say, in my wisdom, that bank loans in a
21 year may be increased by eight and not by six or ten.
22 As a matter of fact, only a week ago I was discussing
23 the subject with the banks, and we agreed we would
24 prolong the half per cent for two months and then add
25 two months of one per cent, because we admitted we came
26 into the period of heavy seasonal demand and that we
27 should take that into consideration. Now we have a total
28 of ten months of half per cent and two months of one
29 per cent, and the total increase over the year would
30 therefore be 7 per cent, but they had a leeway at the



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1 beginning of the year of $1\frac{1}{2}$ per cent; and it all comes
2 out that the admissible increase for this year would
3 be $8\frac{1}{2}$ per cent. This is not arithmetical, but it is
4 tentative. However, there is some thorough thinking
5 behind it. I can rationalize these figures, but I do
6 not pretend it is algebra to figure it out. The banks
7 talk about their own business and they know under what
8 tensions they are, and they react to this kind of thinking,
9 and they say, "It is impossible the demand on credit
10 is so great we could not restrict it to the figures
11 you mentioned," or they react as people who feel they
12 can live up to those conditions.

13 Personally, I take the position-- and it is
14 an important attitude, of course --, that I consider it
15 impossible for central bank policy to be restrictive
16 in the sense you force a reduction of credit upon the
17 private sector of the economy in a boom. I could
18 imagine people telling me, "Why do you allow any
19 increase in credit at all at the present moment? You
20 should reduce credit." My answer is that the economy
21 does not work that way. It is impossible in a boom to
22 reduce credit; or, otherwise, you break the system
23 and create a crisis. But you can restrict it, and you
24 should, under those conditions.

25 COMMISSIONER BROWN: This increase of half
26 a per cent per month is for individual banks?

27 DR. HOLTROP: Yes, and also for the **collectivity**.

28 COMMISSIONER BROWN: Does not this also mean
29 that in a boom period, where there is pressure for
30 additional credit, it ensures all the banks increase at



beginning of the year of 1 1/2 per cent, and it all comes out that the admissible increase for this year would be 8 1/2 per cent. This is not arithmetical, but it is tentative. However, there is some thorough thinking behind it. I can rationalize these figures, but I do not pretend it is algebra to figure it out. The banks talk about their own business and they know under what conditions they are, and they know the kind of conditions and they say, "It is impossible the demand on credit is so great we could not restrict it to the figures you mentioned," or they react as people who feel they can live up to those conditions.

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COMMISSIONER BROWN: Does not this also mean

that in a boom period, where there is pressure for

additional credit, it ensures all the banks increase a



1 the same rate, and to that extent reduces competition?

2 DR. HOLTROP: Yes, it tends to, but there are,
3 of course, banks who are in excess of and banks who are
4 not in excess of this figure. But you are right. That
5 creates even some tensions because the banking community
6 will tell you it is not fair that certain banks, which
7 at this moment or in the last few years, have been growing
8 faster than other banks should be subject to the same
9 restrictions, and that you should take that into consider-
10 ation. There my answer has always been that I admit
11 it is perfectly fair for some banks to grow faster than
12 other banks in periods of normalcy, but in that short
13 period it is necessary to have credit restrictions they
14 should stop to grow faster. It is impossible to take
15 that into consideration. You cannot assign a certain
16 percentage of growth to one bank which you do not give
17 to other banks. But it is true that this system is one
18 meant for only a relatively short period. You cannot
19 go on for years and tell the banks, "You can only
20 increase your loans so much as compared with a certain
21 period, at a basic percentage." Then in a period of
22 relaxation you have to say, "We need not have controls
23 presently."

24 COMMISSIONER BROWN: That is, you re-establish
25 your competitive position?

26 DR. HOLTROP: Yes.

27 COMMISSIONER BROWN: You mentioned you had
28 come to an agreement about allowing an increase of one
29 per cent bank rate for two months, based on seasonal demand?

30 DR. HOLTROP: Yes.



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STAFF: Yes, that is correct.

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the same rate, and to that extent reduces competition?



1 COMMISSIONER BROWN: Is there any thought of
2 soaking up this extra seasonal increase in the following
3 two months after that?

4 DR. HOLTROP: I would have to put it this
5 way, if I fully took the season as far as our experience
6 goes into consideration, I even know, and they know also
7 that the amount of expansion we allow them at the
8 present moment is really too low, even taking the one
9 per cent into consideration, because this is the tax
10 season and the demand for loans will be big. But in
11 the four months from May to August we allowed them a half
12 a per cent increase. Now we know that, seasonally, they
13 should not have increased at all, and they have not.
14 But, as a consequence they have got some leeway because
15 of the slack season in the past four months.

16 COMMISSIONER LEMAN: Is it cumulative?

17 DR. HOLTROP: Yes, it is cumulative for the
18 separate banks and the system as a whole. The punitive
19 conditions of having to make deposits with the central
20 bank only apply when current activity of the banks is in
21 excess of the requirement. At the moment, when the collect-
22 ivity is all right, individual banks do not have to make
23 deposits with us.

24 COMMISSIONER BROWN: Is there any transfer of
25 central bank funds between banks?

26 DR. HOLTROP: That would not help them. There
27 is, because through the call market they can transfer
28 any amount of money between themselves.

29 COMMISSIONER BROWN: But there is no direct
30 trading of what is referred to as federal funds?

DR. HOLTROP: No, because the notion of



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1 federal funds does not exist in our market. There is
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3 on a daily basis, where the banks can exchange their
4 surpluses and deficits.

5 COMMISSIONER MACKINTOSH: When you say you
6 consult the banks and discuss things with them, how
7 many banks have you in mind?

8 DR. HOLTROP: I think the number of registered
9 banks is more than 100 -- something like 120 -- but
10 that includes all kinds of small institutions. We
11 talk ourselves about the representative banks, which
12 we think are important, and they are 36 in number. They
13 are also included in our monthly published statistics,
14 and the smaller banks are not published monthly by us.

15 The banks speak to us through their
16 representative organization, The Bankers' Association,
17 of which all the banks are a member. It is the board of
18 the Bankers' Association which is the body with which
19 we discuss these things and make agreements. At a
20 certain moment they may want to consult their general
21 assembly, to hear whether there are still difficulties.

22 COMMISSIONER GIBSON: Are not there the
23 Big Four which do a high proportion of the total business?

24 DR. HOLTROP: Yes, there are the Big Four
25 which do a large proportion -- between 60 and 70 per cent --
26 of the business.

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COMMISSIONER GIBSON: Are not there the

four other reserve banks in the United States?

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1 COMMISSIONER LEMAN: There is a sentence
2 in your memorandum, Dr. Holtrop, that puzzles me a
3 bit. Perhaps you have answered it this morning, because
4 you have covered so much ground, but I didn't quite
5 get the sense of the answer. It is on page 9:

6 "It is monetary policy alone,
7 that is interested in the level of income
8 and expenditure only, and not in its
9 competition."

10 You have just been dwelling on this, and
11 said that the job of monetary policy is to influence
12 total expenditure. Then you go on and say:

13 "This is, no doubt, the reason
14 why, to such a large extent, the management
15 of monetary policy can be delegated to
16 a non-political authority; the central
17 bank."

18 Do you feel these monetary actions are
19 quite neutral in their incidence?

20 DR. HOLTROP: 100 per cent neutrality
21 would not exist, no, I don't think. After all, by monetary
22 action you can only act on the expenditure of those
23 people who are dependent upon credit, or directly upon
24 those who are dependent on short-term credit. You could
25 not influence the spending of the rest of the community.
26 However, I do not consider that as a great inequity.
27 It is natural that those who have the advantage of being
28 able to make use of short-term credit should also be the ones
29 who are influenced by the necessity of restricting the
30 creation of short-term credit. There is, of course, that

COMMISSIONER LEWIS: There is a sentence

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1 general question, the question which is often discussed
2 as to how far credit restrictive measures do or do not
3 have more influence on the small man than on the
4 big industries. It is not a subject that in our
5 country has ever played an important role.

6 To answer your question, there is
7 some lack of complete neutrality; that does not
8 exist. However, on the other hand, it is neutral
9 in so far as it is left to the choice of the
10 banking system and the fully competitive system
11 of short-term credit to pass on the pressure of
12 a restrictive measure to the community. I
13 think it would bring monetary policy into
14 completely other problems if you would say, for
15 example, that one of the specific purposes of
16 monetary policy ought to be to stimulate growth.
17 Then you would ask, "How do I stimulate growth?"
18 You might say, "I want to grow in the automotive
19 industry" -- or in some other industry.
20 "I want to stimulate investment in certain
21 directions." If that were the way you would want
22 to apply monetary policy you would be completely
23 out of the neutral sphere, and would come into
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1 That is what I mean in this sentence. Now
2 it must be said that it is not 100 per cent correct
3 that we limit ourselves to general measures only,
4 because I must admit that our bank law gives us
5 also the power to limit and restrict certain types
6 of credit. By the expression "certain type of credit"
7 is, for example, meant investment credit as against
8 credit for purposes of inventory financing, but
9 also hire-purchase credit, for example, might be
10 a special type of credit, and we indeed have sometimes
11 by moral suasion influenced the banks in the amount
12 of hire-purchase financing they should do. However,
13 I consider this as only a slight deviation from
14 the formulation in the sentence you quoted, the
15 consideration being that you would like credit
16 to be used as much as possible for productive
17 purposes and not for stimulating consumption.

18 COMMISSIONER LEMAN: As background for
19 this, could you tell us generally how much the
20 consumer loan volume is in the Netherlands?

21 DR. HOLTROP: It is specifically low.
22 The other day I saw an international comparison
23 where we are at the bottom, and the total amount of
24 hire-purchase credit or instalment credit is, I think,
25 not more than 2 per cent of national income. We
26 have a figure there of 40 billion, so the total
27 amount outstanding would definitely be below
28 800 million guilders or 700 million guilders.
29 A large part of that would include credit for
30 professional automobiles financing.

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1 So, the purely consumptive part of our hire-purchase
2 financing is definitely low in our country.

3 THE CHAIRMAN: What is the value of a
4 guilder now?

5 DR. HOLTROP: Thirty per cent of a Canadian
6 dollar, to make it easy.

7 COMMISSIONER LEMAN: How about the very
8 large corporations operating in Holland that are, let
9 us say, we will call them international corporations
10 that have access to foreign funds quite easily?
11 Have you ever used any moral suasion with them?

12 DR. HOLTROP: No. There you touch upon
13 a highly interesting problem which I think central
14 banking generally and monetary policy in the future are
15 facing, and that is the internationalization of our
16 whole economies. It is perfectly true that the
17 possibility of financing yourself with foreign means brings
18 you outside the control of your local central bank, and
19 having access to a foreign banking system makes the rules,
20 which the internal banking system or the central bank
21 has, ineffective as far as you are concerned. If you
22 have a very high proportion of foreign industries which
23 have the choice of financing themselves in other countries,
24 it definitely weakens the possibilities of monetary policy,
25 in my opinion. This may be even more important in your
26 country than with us. With us it is of a certain importance,
27 but I can visualize with the growth of the common
28 market it may become more and more important, because
29 it is a fact that, so far, monetary policy is completely
30 handled on a national basis. If we make restrictive measures



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has, ineffective as far as you are concerned. If you

have a very high proportion of foreign industries which

have the choice of financing themselves in other countries,

it definitely weakens the possibilities of monetary policy

in my opinion. This may be even more important in your

country than with us. With us it is of a certain importance

but I can visualize with the growth of the common

market it may become more and more important, because

it is a fact that, so far, monetary policy is completely

based on a national basis. If we make restrictive meas-



1 for our banking system, we make restrictive measures.

2 for the loans they make within the country, and leave
3 them free -- well, we allow them to make loans outside
4 the country, and those loans they make outside the
5 country would not come under the control of the central
6 bank of that country. It is a very interesting point: that
7 with the internationalization of the world the control
8 of national banking systems tends to weaken.

9 --- Luncheon adjournment.



1 The following system, or some modification thereof,
2 for the future may be adopted: the central
3 bank of the world, or some other body, should
4 be authorized, and would have the right to
5 issue currency, and would not come under the control of the central
6 bank of that country. It is a very interesting point: the
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1 --- On resuming at 2.15 P.M.

2 THE CHAIRMAN: Dr. Holtrop, with
3 reference to near banks, the agricultural credit banks
4 would not be classed as near banks?

5 DR. HOLTROP: No, they are classified as
6 banks.

7 THE CHAIRMAN: Yes, because they accept
8 deposits as a business?

9 DR. HOLTROP: Yes.

10 THE CHAIRMAN: And the security credit
11 institutions you mention in your memorandum: would
12 they be near banks, or would they be banks?

13 DR. HOLTROP: All those that are of any
14 importance and at the same time taking deposits and
15 making loans are classified as banks.

16 THE CHAIRMAN: That is their business?

17 DR. HOLTROP: Yes.

18 THE CHAIRMAN: What is the difference? What
19 is the distinguishing feature of the security credit?

20 DR. HOLTROP: They are really what you would
21 call stock brokers. They are somewhat developed stock
22 brokers, who do some part of the banking
23 business for this private clients. A stock broker pure
24 and simple might not take deposits and might not make
25 loans. A stock broker with private clients has a kind
26 of small banking business because he may take deposits in the
27 sense that any surplus liquidity of his clients may
28 be left with him, and so it is a form of taking deposits. If
29 he also makes loans, then we classify him as a security
30 credit institution: that is, he is not a member of the

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1 Bankers' Association. He is from a monetary point of view
2 of minor importance, but he comes under the same rules of
3 supervision of ours. If his business is developed to
4 any importance, then he comes in the classification
5 of banks.

6 COMMISSIONER MACKINTOSH: To turn the Chairman's
7 question around, what in your country would you think
8 of as near banks?

9 DR. HOLTROP: Well, the nice thing is we
10 haven't got them, really. It makes many of our problems
11 so simple, because I recognize that in the situation
12 as you know it here -- and as it is also known in other
13 Anglo-Saxon countries: for example, in South Africa,
14 that you have to cope with a problem in deciding how
15 to handle the near banks. We know the financing institutions
16 which you might say are near banks because they are in
17 the banking business, but with us they don't take deposits.
18 They finance themselves by loans, not by deposits.

19 THE CHAIRMAN: Those are the finance companies.

20 DR. HOLTROP: Hire-purchase finance companies.
21 They may be subsidiaries of banks. We hardly ever discuss
22 in our country the problem of near banks because we
23 do not have a category of institutions that creates that
24 problem.

25 THE CHAIRMAN: You have the statutory power
26 to control all these institutions?

27 DR. HOLTROP: As soon as they take deposits
28 and make loans, then they are by statute under our control.

29 THE CHAIRMAN: The hire-purchase companies,
30 apparently -- at least, from my understanding of what



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THE CHAIRMAN: The hire-purchase companies,

apparently -- at least, from my understanding of what



1 you had said this morning -- are probably the largest
2 group of companies that deal in what you might call
3 near banking business.

4 DR. HOLTROP: They are not under our control.

5 THE CHAIRMAN: Most of them do not accept
6 deposits in the ordinary sense?

7 DR. HOLTROP: No, they don't. The situation
8 may have been influenced by our legislation, but
9 also before the legislation was there we never had
10 developed the tradition of institutions which were
11 taking deposits for that purpose. Those institutions
12 which specialize in hire-purchase financing have
13 always taken long-term borrowing from the market
14 and have been partly financed also for their surplus
15 requirements by the banks themselves. Many of them
16 are subsidiaries of the banks.

17 THE CHAIRMAN: You say at page 35 in
18 paragraph (d):

19 "A useful indication of the
20 monetary significance of the institutions
21 concerned might be found in the velocity
22 of turnover of their deposits, or of
23 any special group of their deposits.
24 I believe that any yearly velocity
25 of turnover in excess of unity
26 should be looked upon with suspicion."
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1 Could you elaborate on that a bit?

2 DR. HOLTROP: I am not sure whether the
3 wording is exactly what I mean. You ask me a theoretical
4 question about a situation which we do not know in our
5 own country. We might know something comparable to it
6 in the case of some of our savings banks which have developed
7 in such a way that they have been giving facilities to
8 their customers that really come into the range of
9 near bank facilities. The rate of turnover of their
10 deposits may then increase with the facilities they
11 give. If these facilities include the making of
12 payments directly out of the account, and taking care of
13 and accepting automatic deposits out of pension payments,
14 for example, and things like that, they may develop such
15 accounts into a kind of cash reserve for the holders of
16 these deposits. They then get near to what I call the
17 money supply. But, generally, we find that the average
18 rate of turnover in the savings accounts in Holland is
19 well below one-half. So, the average time of deposit is
20 over two years, which identifies them clearly as real savings
21 deposits. When the rate of turnover gets below one,
22 the average time of a ~~money~~ deposit is less than
23 a year and you get into the sphere of institutions
24 which might just be an intermediate in the use of
25 monies that are only seasonally available. In my way
26 of thinking they get into the monetary sphere. For private
27 people the fluctuation in their cash balances may be
28 connected with the time of the payments of incomes, so they
29 may have monthly fluctuations, but in business there are
30 seasonal fluctuations many businesses will have surplus
 funds during a part of the year and be somewhat short of funds



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are not really saving, but they are saving in the sense

that they are accumulating funds for the future.



1 and make use of bank loans in another part. The
2 institutions who would make use of these temporary deposits
3 which become available for only part of the year and who
4 by their substitution can create a permanent line of credit
5 on the basis of these temporary deposits, very clearly
6 are in the sphere of monetary action. This is a
7 technique of increasing the velocity of circulation of
8 money, or of the creation of money when you really recognize
9 that the deposits they take have the function of cash
10 money for the depositors. Taking the one-year period,
11 as soon as you get beyond a velocity over one, then
12 apparently you are already receiving monies that
13 are only for a part of the year available in the hands
14 of the depositor, and therefore you get into the
15 monetary sphere. Do I make myself clear?

16 THE CHAIRMAN: Yes, I think I understand.

17 DR. HOLTROP: It is mainly the seasonal
18 factor that I have in mind there.

19 COMMISSIONER LEMAN: If your consumer finance
20 companies use mostly medium and long-term funds, would
21 it follow that their rates to the consumer would tend
22 to be higher than those who would be allowed to use
23 very short-term and even deposit money?

24 DR. HOLTROP: As far as I know, in hire-
25 purchase financing effective rates tend to be higher than
26 the rates for bank loans, and certainly for prime bank loans.
27 Consequently there would be some margin there for a somewhat
28 more costly way of financing and for all the administration
29 involved.
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COMMISSIONER LEWIS: If your consumer banks
generally use mostly medium and long-term funds, would
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to be higher than those who would be allowed to use
very short-term and even deposit money?

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Consequently there would be some margin there for a somewhat
more costly way of financing and for all the administration
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1 COMMISSIONER BROWN: Have banks gotten into
2 that field?

3 DR. HOLTROP: They have got to a certain extent
4 in that field. We have a bit discouraged it. I think
5 in the middle 50's we had, by way of moral suasion, asked
6 the banks to limit the expansion of their loans and
7 their financing to hire-purchase finance companies.
8 In the course of time they have taken an interest
9 in these companies and some of them have been taken over
10 by important banks, so banks have a certain stature in
11 this field.

12 COMMISSIONER BROWN: Are the banks making
13 the loans directly?

14 DR. HOLTROP: No, they are using these
15 companies for that purpose.

16 COMMISSIONER LEMAN: Dr. Holtrop, I have a
17 couple of questions to ask you about the effectiveness
18 of monetary policy as managed by a central bank.

19 DR. HOLTROP: Yes.

20 COMMISSIONER LEMAN: This morning in answer
21 to some of our questions you have covered a lot of ground,
22 so that in part my questions may come back a little to
23 what you have said; I am not too sure if some of the
24 answers might not be on the record already, but I am
25 not sure because they didn't come to you as questions
26 specifically on these points.

27 One of them is your strong feeling, apparently,
28 that in this field it is much more the confidence in
29 the availability of money for business purposes that
30 will influence the results you were trying to achieve,



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1 rather than just the price of the money. I believe
2 yesterday a witness told us that he felt that in
3 certain circumstances where the pressure of demand is
4 not so high, where we are not in a very strong and durable
5 boom sort of atmosphere, then he believes that the
6 price was quite an important factor. Could you state
7 your position a little bit more precisely?

8 DR. HOLTROP: I think this has ever been a
9 controversial point. This is also true in economic
10 literature, also there are different attitudes,
11 different opinions have been taken. It has always
12 been stressed and it is generally known that in long-
13 term financing public utilities and house building are
14 examples of types of financing where the rate of interest
15 plays an important role. It is also true that the
16 expectations about the rate of interest will play a certain
17 role in investment decisions. In the field of short-
18 term financing it has always been held that the
19 rate of interest does play a role in the financing
20 of inventories, as the cost of carrying stocks
21 is, of course, partly determined by the rate
22 of interest.

23 I do not know, however, of investigations
24 that have been properly done in this field to measure
25 any elasticity of demand; or to determine the reaction
26 of trade and industry to fluctuating in the rate
27 of interest, in respect of the volume of
28 their stocks. I would still say, that in the speculative
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1 field, if you have expectations of a price rise,
2 these will easily outstrip the difference in cost
3 due to different rates of interest. So there I
4 doubt whether the rate of interest is of such
5 importance in the calculation of the borrower.

6 We must, moreover, make clear that if you
7 ask this question you ask not what influence the
8 rate of interest may have on the way of financing,
9 but on the volume of the expenditure, whether the
10 volume of expenditure is influenced by the rate
11 of interest and whether somebody will abstain from
12 a certain investment because the rate of interest
13 is one per cent higher or whether he may abstain from
14 carrying a certain amount of stocks because the
15 rate of interest is one per cent higher. There
16 I am inclined to think that the consideration of ability
17 of being able to get financing is of more importance
18 than the rate as such, and that the influence of a
19 raise of the discount rate -- that is the increase of
20 the rate of discount as it has been mostly used in
21 Europe, as a signal from the central bank -- on the volume
22 of expenditure, is rather based on the warning effect than
23 on the cost effect. When the rate of discount goes up it
24 is a warning for everybody that apparently the central
25 bank sees a certain limitation of financing possibilities
26 in the future. That warning to the business community will
27 be taken into consideration in all the long and short-term
28 investment decisions; but that will not then be, in my
29 opinion a reaction to the increase in rate as such, but rather
30 to the expectation of the financing possibilities and the
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St. Louis, Mo.

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1 So, the answer is, indeed that I am inclined
2 to believe that the elasticity of demand for credit to
3 the rate of interest is not very high; that there are
4 certain fields where we know that it is of importance --
5 and I have mentioned them -- but that in other fields
6 the elasticity is rather rigid and that therefore
7 it is not purely the rate to which a business community
8 reacts, but far more to the expectation of being able
9 to finance.

10 COMMISSIONER LEMAN: Because when you are
11 trying to influence the total rate of expenditure you
12 are then dealing with the whole spectrum of prospective
13 investments, and certainly in a given country there will
14 be also a whole spectrum of profit margins ---

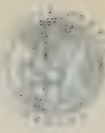
15 DR. HOLTROP: That is right.

16 COMMISSIONER LEMAN: And you are always looking
17 only to influence the marginal borrower, are you not?

18 DR. HOLTROP: That is right.

19 COMMISSIONER LEMAN: so that, in theory
20 would it not seem logical that that would at least discourage
21 the marginal ones and that that might give you just the
22 leverage you need for your total expenditure reduction?

23 DR. HOLTROP: Then, my question would be what
24 do we know about the volume of these marginal ones;
25 is that sufficient to get the reaction we wish or not?
26 I would immediately answer that, as soon as you talk about
27 the two per cent rate increase, the differences in the
28 rate of interest would of course be that important
29 that you get reactions. With small differences
30 I doubt whether you do get that reaction and,



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1 at any rate, I can only say that we have looked upon
2 monetary policy in that respect more from the quantitative
3 point of view than from the point of view that the
4 rate of interest by itself would sufficiently influence
5 the spending decisions of the community. I know this
6 problem plays its part in the Radcliffe investigation
7 also, and I understand that when you come to the point
8 where it is impossible to observe the quantitative
9 relations you are almost bound to believe that it is
10 the rate of interest that will give sufficient reactions --
11 but I don't think we know enough to say for sure how
12 the situation is.

13 COMMISSIONER MACKINTOSH: What would you think
14 about the effect of the rate of interest on the rate
15 of savings?

16 DR. HOLTROP: Again I am inclined to believe
17 that the influence of the rate of interest is greater
18 on the form in which you keep your savings than on the
19 amount of the savings.

20 That leads to the whole question of an
21 analysis of where savings come from. As you know,
22 nowadays a large part of the savings come from surplus
23 profits and there, of course, it is not the rate of
24 interest that induces the savings, it is the profit
25 that determines them.

26 Government savings is a question, of course,
27 of taxation and volume of expenditure and isn't
28 influenced by the rate of interest. As far as private
29 savings are concerned I have never believed that
30 people changed their goals in that respect because
the rate of interest is one-half a per cent higher or a

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1 per cent higher. At the moment that one comes to
2 exceptional rates people will probably buy on the
3 short-term to profit from those rates. If you get to
4 the "magic fives" or "sixes", or beyond, you probably
5 get short-term reactions to profit from that rate.
6 On the long-term I doubt whether you do.

7 THE CHAIRMAN: Doesn't it depend somewhat
8 on the extent to which the institution advertises for
9 savings? There are some institutions which advertise
10 very vigorously to attract savings and are offering
11 4 per cent for deposit money, demand money, and I would
12 think a great many people who have idle balances may
13 be persuaded that the advertisement is sufficiently
14 colourful and attractive ---

15 DR. HOLTROP: That is what I meant ---

16 THE CHAIRMAN: To invest their savings?

17 DR. HOLTROP: That is what I meant when I said
18 that the rate of interest has more influence on the
19 direction in which savings are being invested than on
20 the savings themselves. Do you think that advertising
21 will decide people not to spend their weekly income?

22 THE CHAIRMAN: I was thinking of the people
23 who don't bother putting their money in a savings
24 bank; they hold it in a current account.

25 DR. HOLTROP: Yes, definitely.

26 THE CHAIRMAN: It is very difficult.

27 DR. HOLTROP: Yes, I think you are right; the
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short-term to profit from those rates. If you get to
the "magic five" or "sixes", or beyond, you probably
get short-term reactions to profit from that rate.
On the long-term I doubt whether you do.

THE CHAIRMAN: I am not sure whether you do.

savings? There are some institutions which advertise
very vigorously to attract savings and are offering
4 per cent for deposit money, demand money, and I would
think a great many people who have little balances may
be persuaded that the advertisement is sufficiently
colorful and attractive ---

DR. HOLTROP: That is what I meant ---

THE CHAIRMAN: To invest their savings?

DR. HOLTROP: That is what I meant when I said

that the rate of interest has more influence on the
direction in which savings are being invested than on
the savings themselves. Do you think that advertising
will decide people not to spend their weekly incomes?

THE CHAIRMAN: I was thinking of the people

who don't bother putting their money in a savings

bank; they hold it in a current account

DR. HOLTROP: I am not sure whether you do.

THE CHAIRMAN: It is very difficult.

DR. HOLTROP: Yes, I think you are right; the



1 rate of interest will certainly influence it, but
2 it is not the volume of saving by itself, it is the
3 form of the savings. I definitely agree that the rate
4 of interest has an influence on the amount of liquid
5 wealth people will hold in the form of money or near
6 money; we observe that also, and that is one of the reasons
7 why we have ourselves in our monetary analysis rather
8 given up to work with the notion of money proper, and
9 are giving more value to the notion of liquidity --
10 that is money and near money together -- because we indeed
11 believe that the rate of interest influences people in
12 putting money in a bank or an institution or holding it
13 in cash, and also that the business community will be
14 decided by the rate of interest whether they go to the
15 trouble of putting it on deposit or holding it in a current
16 account.

17 COMMISSIONER BROWN: Do you think we will get
18 into perverse reactions when interest rates start to
19 go up so businesses that fear non-availability of
20 credit will obtain it now rather than take the chance
21 of waiting?

22 DR. HOLTROP: No, we haven't observed that
23 to any extent, no. If you make intricate restrictive
24 regulations then you might indeed incite that kind
25 of reaction -- but under normal conditions of
26 practice in the rate of interest we have not
27 observed that, no.



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1 COMMISSIONER GIBSON: You put a great deal
2 of emphasis in discussing how monetary policy works
3 on expectations; money will be hard to get or will
4 not be available, and I take it this is the most
5 important way in which you think it actually works.
6 Now, what about expectations that the business
7 climate might change which is induced by a change
8 in central bank policy? Do you think this is an
9 important factor, the thought that business may
10 change or that the boom is pretty nearly over
11 in the central bank's opinion in making postponed
12 decisions to invest?

13 DR. HOLTROP: It may indeed play a role.
14 But I am inclined not to believe that the raising
15 of the discount rate by itself -- at any rate, in
16 our own circumstances -- would for that reason only
17 create sufficient of an expectation that the
18 boom will be broken.

19 COMMISSIONER GIBSON: As an additional
20 reaction, but what is your opinion as to the most
21 important?

22 DR. HOLTROP: If you are increasing the
23 rate of discount in time so that it is well before there
24 is a break in the boom, there are so many reasons to
25 believe that conditions, after all, are very favourable
26 for investment, that the sheer fact that the discount
27 rate is raised will only be a warning to a few people.
28 The choice of the way of financing will perhaps be
29 influenced already in an early period because people
30 will feel that the discount rate being raised might indicate



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1 higher interest rates in the future -- it certainly
2 will then be an incentive to go at an earlier time
3 to the long-term market.

4 COMMISSIONER LEMAN: To put Mr. Gibson's
5 question in a slightly different form, if they become
6 convinced that monetary policy is effective, and therefore
7 successful, then it could lead to the kind of conclusion
8 which Mr. Gibson is suggesting?

9 DR. HOLTROP: This is also speculative, I
10 think we can't know about these things. This is all
11 conjecture and different people will react in a different
12 way, and I would not say that it is my expectation that
13 the mere fact of restrictive policy would create an
14 atmosphere of expectation of a turn in the business
15 cycle and that by that reason only investment decisions
16 are already influenced to a large extent. I think
17 that would go a bit too far.

18 COMMISSIONER GIBSON: Would it be fair to
19 say that if the action was very strong, such as the
20 British increase in the bank rate of 7 per cent?

21 DR. HOLTROP: Yes, but that is another thing.
22 There you are quite right. Certainly if you live in
23 a situation of inflationary expectancies and then
24 suddenly government and central bank policy together
25 show that the authorities are not going to allow these
26 conditions to continue, then, of course, you might break
27 the inflationary expectancies and that might have a
28 forceful influence. I think that indeed the jumps we
29 have had from 5 to 7 per cent have worked that way.
30 In Holland in 1957 we had a slight foreign exchange
crisis and then

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1 there was also a forceful increase in the rate of
2 interest; well, it not only helped to recreate
3 confidence but also was a warning to the business
4 community that these exceptional expenditures shouldn't
5 be allowed to continue, and that certainly gave
6 a reaction.



Page 10

There was also a warning to the rate of
interest, and, if not only, it was to be
applied to the business also was a warning to the business
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1 COMMISSIONER LEMAN: Dr. Holtrop,
2 to go on to a slightly different point from that
3 Mr. Gibson touched on this morning, but still in the
4 realm of effectiveness of monetary policy, you have
5 explained to us that it has a very limited role, and
6 must be used only in the way and in the field in which
7 it can be effective. But, within that limited
8 area, have you in the Netherlands attempted to make
9 fairly precise measurements of how fast it works,
10 or as to how long it takes for the turn around to come
11 about, et cetera.

12 DR. HOLTROP: No, we have not make
13 measurements of lags because I do not think the thing
14 is pointed enough for that purpose. With respect to
15 countries like the Netherlands it is the general business
16 atmosphere and the business cycle in the world which
17 play an enormous role in the business community. Take,
18 for example, the turn of the cycle in 1957. Having
19 the benefit of hindsight it appears that the turn in
20 the cycle came exactly at the same time as in the United
21 States, so in that case you come to the conclusion that
22 the real turn of the cycle was after all influenced
23 by general world conditions, and was not purely a
24 consequence of local monetary policies. Local monetary
25 policies certainly have helped in restraining the
26 exaggeration of the cycle, but the fundamental development
27 of the cycle was apparently governed by general conditions
28 in the world. So, this would make it difficult to make
29 close observations of the lags in reaction to policy measures.

30 After all, in these phenomena you can



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1 observe what happens, but you never know what would
2 have happened without your policy. Even at the
3 present moment, more than a year after we applied
4 restrictive measures we cannot be quite sure about
5 the results of the measures because we cannot know
6 what would have happened if we had not taken those
7 measures.

8 I can only observe, for example, that
9 the expansion of credit has slowed down when compared
10 with the period before. I cannot know what the
11 exact difference would have been as between what would
12 have happened without the measures and what has happened
13 with the measures. In that respect, what you do is
14 necessarily tentative.

15 There is always, of course, the matter of lags
16 because when I say your ultimate purpose is to influence
17 expenditure the fact has to be recognized that monetary
18 policy, in the first instance, often only has an influence
19 on the ways of financing, and the choice of ways of
20 financing only indirectly affects expenditure. Ways
21 of financing influence the future expenditure, because
22 when shifting from bank loans to the capital market you
23 take away the means of financing of other people who might
24 have used them quite some time later and who at that later
25 time do not find the means of financing, and who by then
26 have to change their investment plans.

27 I do not think that close observation there is
28 really possible, but by deduction you know there always must
29 be lags.

30 Another thing is that in the superficial movements
you can find quite prompt reactions. In so far as



1 your monetary policy has the other objective -- not
2 the fundamental objective of influencing expenditure,
3 but, for example, the objective of defending your
4 foreign exchange reserves -- you do find prompt
5 reactions there. If you increase the rate of interest
6 by 2 per cent, you will get a reflex reaction of funds to
7 the money market, and that reaction will be very prompt.
8 Those are superficial movements; it is indeed movement
9 you want, but they are not the fundamental movements
10 in total expenditures to be induced by monetary
11 policy as such.

12 COMMISSIONER LEMAN: But, in general, selective
13 controls act rather fast?

14 DR. HOLTROP: Do you mean selective controls
15 in the sense ---

16 COMMISSIONER LEMAN: In the sense that you have
17 used them within the general definition of moral suasion.

18 DR. HOLTROP: The moral suasion controls
19 were not really effective. We have known periods
20 in early times after the war where our system of
21 control of credit was purely on a selective basis --
22 namely on the qualitative basis. That was still
23 based on the war economy rules, and the banks had to
24 submit to us any loan above 50,000 guilders for
25 our approval. There you had purely selective controls,
26 but we have never been satisfied with them. We have
27 been glad to give them up after a few years and
28 change them for the system of general quantitative
29 controls as foreseen in the present act.

30 COMMISSIONER LEMAN: I have one more question,



1 Dr. Holtrop. It is not strictly in the same field,
2 but this morning you described to us how one must take
3 a look at all the major economic factors that have
4 to be dealt with, and you said that some of the
5 monetary policies were not well adapted to bring
6 about cures in such things as certain types of
7 unemployment, et cetera. In your country is there
8 a super-economic council, if you might call it that,
9 that looks at these things, or is that done mostly
10 by the bank, or is it done somewhere else in government?
11 Is there a recognized economic advisory board, or
12 something of that type?

13 DR. HOLTROP: I have to answer that question
14 in two ways. There are two different things. On
15 the one hand there is what we call the Central Planning
16 Bureau which really is the economic research department
17 of the government. This is a branch of government.
18 It is in the ministry of economic affairs, and it has
19 a very high professional standing. It analyses the
20 trends of the economy. It was built up under the
21 leadership of Professor Tinbergen who was the first
22 director of the institute. It worked out a so-called model
23 for the Netherlands economy which has made it possible,
24 on the basis of the suppositions of that model, to say
25 what the probable consequences would be of possible
26 policy measures. Every year it makes a plan for the
27 next year which is a great help to the government in
28 making up its budget, and, generally, in the forming
29 of an opinion about what is, or is not, admissible as
30 development in the fields of wages, prices, et cetera,



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2 I must say that I think the work of this
3 bureau is of the highest importance. Also we as a
4 central bank co-operate with the Central Planning
5 Bureau inasmuch as we supply them with financial
6 data, and we consult with them on financial inter-
7 pretations.

8 They have introduced into this model
9 certain supposition about the reactions of the economy
10 to a less liquid state and to a more liquid state,
11 and more specifically to the effect of the liquidity
12 of business on the volume of investments, for instance.
13 We ourselves place very much value upon their
14 estimates which partly influence our own policies.

15 For example, in the determination of
16 admissible growth of bank loans we have taken into
17 consideration the estimates of the Central Planning
18 Bureau about the increase in real income that was
19 to be expected under the present conditions in the
20 current year. The Central Planning Bureau is, therefore,
21 purely an economic advisory body, and not at all a policy-
22 making body. It is simply a help to the government.

23 On the other hand, we have another body
24 which is representative of the community as a
25 whole. It is called the Social Economic Council.
26 The Social Economic Council is a body of 45
27 members representing the business community in the
28 sense that one-third of its members represent the
29 entrepreneurial organizations; one-third represent the trade
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2 members appointed by the government. I myself
3 belong to this body as a government appointee.

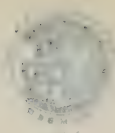
4 By law the government has to submit
5 to this body for its advice any important bill
6 which it intends to present to parliament, so that
7 any legislation in the economic field which the
8 government plans to make has to be submitted to
9 this body for advice. It is an advisory body,
10 and it plays an important role.

11 It plays an important role also in
12 the discussion of economic conditions in the country,
13 and of economic expectations. It plays a role
14 also in labour-entrepreneur relationships, and
15 this, again, is in an advisory capacity. The
16 director of the Central Planning Bureau is one
17 of the government members of this body, he being
18 one of the fifteen government representatives.
19 The Central Planning Bureau also functions as the
20 supplier of the economic data to this body, and in
21 its consideration and investigation of problems the
22 Central Planning Bureau will supply it with the
23 statistical background. So, it will be seen there
24 is co-operation between these two bodies.

25 Does this sufficiently answer your
26 question?

27 COMMISSIONER LEMAN: Yes, but the bank
28 forms its own judgment?

29 DR. HOLTROP: Yes, the bank is completely
30 separate. The bank forms its own judgment, but it



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1 definitely uses the material supplied to it by the
2 Central Planning Bureau, and works in close contact
3 with the Central Planning Bureau. However, as
4 regards bank policy, that is completely a bank
5 responsibility, and is not involved in the
6 responsibility of the Social Economic Council.

7 COMMISSIONER LEMAN: And these bodies
8 are more concerned with the somewhat longer range
9 phenomena than the bank is?

10 DR. HOLTROP: That is right, because
11 in this respect they are mainly concerned with
12 legislation, and only then in an advisory capacity.

13 COMMISSIONER BROWN: Mr. Chairman and
14 Dr. Holtrop, I wonder if I may move along to your
15 techniques of debt management. Perhaps the way
16 of opening up this subject would be to ask you to
17 tell us of the routine that is carried out when
18 some new long term or short term borrowings are pro-
19 posed on the part of the government. I gather
20 the government operates its own agency on this?

21 DR. HOLTROP: Yes. The peculiar
22 thing, of course, is that from the point of view
23 of a country where debt management plays such an
24 important role it is queer to look at a country
25 where debt management plays such a relatively un-
26 important role. In that respect my country is
27 different from yours. Debt management in my country
28 is completely the responsibility of government.

29 The tradition in the last ten years,
30 I might say, of government has been that with respect

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1 to any deficit it has to finance it is considered
2 a matter of course that it will finance through
3 long-term borrowing. The market for long-term
4 borrowing is completely separate from that for short-
5 term borrowing.



1 Long-term borrowing is done in the capital market with
2 loans, usually running from zero to 25 years, or from
3 ten years to 25 years, or to 30 years, or to 40 years.
4 The length of the term depends upon circumstances in
5 the market, and the type of institution to which the
6 government hopes to sell the bonds, and as to what
7 those institutions prefer. The savings banks will have
8 a preference for the shorter terms. Life insurance
9 companies may have a preference for the somewhat
10 longer terms.

11 This long-term borrowing is clearly
12 borrowing out of long-term savings -- that is, the
13 long-term savings that get into the hands of the
14 savings institutions, or the life insurance companies
15 and the pension funds. Some of the money also comes
16 from the public. There was a period in which the public
17 did not partake very much in the bond market. They used
18 to partake in the pre-war days, but the inflationary
19 period of the 40's was not very conducive to investment
20 by private people in long-term bonds. But I must say
21 that that condition has already changed now. With
22 high prices on the stock exchange and, later, with
23 the drop in the market, the general public has now
24 again become interested to a certain extent in long-
25 term bonds. That goes back to the old pre-war Dutch
26 tradition that anybody who had some private fortune
27 invested part of it in bonds, though, indeed, the part
28 that is invested in bonds today tends to be smaller
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1 than that of before the war.

2 The amount of long-term borrowing by the
3 government will be determined, of course, by a
4 comparison between the total amount of government
5 expenditure and the amount of taxation. In the development
6 of things of late the amount of taxation has been very
7 high because we have been in boom conditions for a
8 relatively long time. Entrepreneurial profits have
9 been favourable and therefore tax income has been high.
10 The result has been that the government has done
11 relatively little borrowing for the purpose of
12 financing its own expenditure, and the total budget,
13 which includes the extraordinary budget, has either
14 been in equilibrium or it has shown only a small deficit,
15 and even so that deficit has been smaller than the
16 total amount of long-term investment that has had to
17 be done by the government departments themselves.

18 By "government department" I mean, for
19 example, the government pension fund. In our country
20 the investment of the government pension funds is being
21 taken care of by an independent supervisory body
22 which will have a certain preference for investment
23 in government bonds. The total that government
24 institutions have to invest is some 600 million guilders
25 a year, and it is a long time since the government
26 deficit has exceeded 600 million guilders a year.
27 In recent times the deficit has always been smaller
28 than that.



Government will be determined, of course, by a comparison between the total amount of government expenditure and the amount of taxation. In the development of things of late the amount of taxation has been very high because we have been in boom conditions for a relatively long time. Entrepreneurial profits have been favourable and therefore tax income has been high. The result has been that the government has done relatively little borrowing for the purpose of financing its own expenditure, and the total budget, which includes the extraordinary budget, has either been in equilibrium or it has shown only a small deficit, and even so that deficit has been smaller than the total amount of long-term investment that has had to be done by the government departments themselves. By "government department" I mean, for example, the government pension fund. In our country the investment of the government pension funds is being taken care of by an independent supervisory body which will have a certain preference for investment in government bonds. The total that government institutions have to invest is some 600 million guilders a year, and it is a long time since the government deficit has exceeded 600 million guilders a year. In recent times the deficit has always been smaller



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1 On the other hand, the government has, of
2 course, to continually make repayments on existing
3 loans; these repayments form part of the budget, and
4 the government has to borrow in the market for that
5 purpose. I think that is about all I have to say about
6 long-term financing.

7 With respect to short-term financing, it is
8 a long time since the government has been engaged in
9 additional short-term financing in the market.



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1 The short term debt, as a matter of fact, has had the
2 tendency to be reduced. In the continual renewal of
3 the short term debt there is, of course, a factor of
4 debt management, but I would say that that is not such
5 a very important factor. It is the choice in the
6 range between, on the shorter end of the market the
7 three months' bills, and on the longer end of the market
8 the five years' treasury notes. That range represents
9 what we call short term financing, and the government
10 will more or less adapt itself to market conditions
11 with a certain wish always to increase the longer terms
12 of its borrowing when she thinks the conditions are
13 favourable. So when she thinks she can get up to five
14 years' money at a rate which does not very much exceed
15 the rate for a year's paper, she will have preference
16 to place the longer term paper.

17 I must say that fundamentally with a
18 stable amount of short term government debt the
19 government has to adapt itself to the market conditions,
20 and the market conditions are really ruled by the
21 exigencies of those who hold short term funds for
22 liquidity purposes. That is quite a range of people.
23 On the one hand there is the banking system which
24 has to hold short term government paper on which to
25 fall back in the case of their deposits being taken
26 out; and there are the insurance companies, and so on,
27 and finally the business community which has liquid
28 funds and will, to a certain extent, also invest in
29 short term government paper, instead of
30 placing them on deposit with the banking system.



1 There is free competition between these.

2 This situation, of course, is a
3 situation which is presently very different from
4 the problems of the debt management with which those
5 countries are faced, that really have run up a very
6 large amount of short term debt in the war years,
7 or in other periods, and that are continuously faced
8 by the question as to how they could lengthen
9 the average maturity of their debt. It is especially
10 different from the situation in those countries where the
11 clear division between short and long term financing
12 does not exist. In the United States and in England this
13 is a problem, and, as I understand, also in this country.
14 Because of the different traditions of the market,
15 we have that clear division between short and long term,
16 a clear division which is accentuated by the fact that
17 our long term debt as a rule never has fixed maturities,
18 but it is being repaid year by year. Thus a 25-year
19 loan -- I mean, running from zero to 25 years will on
20 the average be repaid to the extent of 4 per cent per year.
21 So you cannot buy a bloc of that loan and know you are
22 going to get your money back three years hence.
23 Consequently these loans will not have the tendency to
24 become money market paper because you never know for
25 sure when the individual bond you buy will be repaid,
26 repayment being effected by a lottery system.

27 COMMISSIONER BROWN: Is it all done by
28 lottery, or does the government buy in the market?

29 DR. HOLTROP: No, it is generally not the habit
30 of the government to intervene in the market. In the



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COMMISSIONER BROWN: Is it all done by
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1 long term market there is, for all practical purposes,
2 no government intervention. The bank has never intervened
3 in the long term market yet, though we have the power
4 to do so. We have never been in a situation where
5 we had the feeling we needed to acquire a long term
6 portfolio, and not having got into that situation we
7 have never been in a position to exercise an influence
8 on the long end of the market. The government funds
9 do some regular buying, and there there may be some
10 indirect intervention in that sense. I now refer to
11 the government pension fund. But, as I already
12 mentioned, they are managed by independent bodies, so they
13 are not under the simple directive of the minister of
14 finance, but under the directive of a body that controls
15 their investment propositions. They will take their
16 decisions in their own merits and at a certain moment
17 will buy or sell in the market; but that is not, of
18 course, pure government intervention.

19 COMMISSIONER BROWN: Perhaps I could ask
20 you a question in which you would have a purely
21 objective interest: that is, what is your opinion
22 as to a central bank operating in the long term bond
23 market?

24 DR. HOLTROP: I have no objection at
25 all to the central bank, as a matter of principle,
26 operating in the long term market, because I can
27 see some advantages. The problem is, however, when do
28 you build up a portfolio? You can only acquire a
29 portfolio by inflationary action, because you create
30 money in order to buy long term debt, unless you were to



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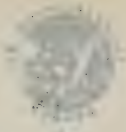
money in order to buy long term debt, unless you were to



1 agree with the government that the government at a
2 certain moment would replace a part of the short term
3 portfolio of the Bank by long term paper. That proposition
4 has never arisen with us. Of course, theoretically,
5 the advantage of being able to operate in the long
6 term market is that you have a more direct action
7 than when you only operate in the short term market.
8 But we know from the American controversies that it is
9 a difficult problem, because the longer term market
10 is very sensitive to government interference; and if
11 there is a lot of government interference you do not
12 have a real market any more, and people may tend to
13 distrust the market at all.

14 With us, we have the tradition that the
15 long term rate of interest is not an object of policy,
16 but it is really the result of market conditions;
17 and being the result of market conditions every
18 investor knows the market can go against him, but
19 not the government or the central bank. That is also
20 an advantage, I think.

21 I can only repeat, however, that we have the
22 power. The Bank Act gives us the power also to buy long
23 term bonds. But we have never yet been in a position
24 to acquire them. I could conceive circumstances
25 of depression, or depressive conditions, that would
26 be conducive to building up a long term portfolio
27 in the hands of the bank, namely when under de-
28 pressive conditions you want to get the long term
29 interest rate further down in order to have a stimulative
30 effect on the market. But in Holland since the war,



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1 those conditions have never arisen, and, therefore, we
2 have never had to take that decision.

3 COMMISSIONER BROWN: What sort of
4 relationship exists between the long term interest
5 rate on, say, your corporate securities and a new
6 government bond issue?

7 DR. HOLTROP: The difference would not
8 be more than about half a per cent. At the present
9 moment the government could borrow at $4\frac{1}{4}$ per cent,
10 and good industrial bonds would be placed at $4\frac{3}{4}$ --
11 not more than half a per cent difference between the
12 two. The municipal bonds would be just in between.
13 Recently they have been borrowing at $4\frac{1}{2}$ per cent.

14 COMMISSIONER BROWN: There is one
15 sentence on page 27, which is the last sub-paragraph
16 of paragraph 47, where you say:

17 " The bank advises the government
18 with respect to the government's
19 operations. It will not operate
20 itself without previous consultation
21 with the government."

22 Could you clarify that just a little? I am a trifle
23 confused.

24 DR. HOLTROP: I meant it this way: the
25 government, of course, is completely responsible for
26 its own action in the short term market. It acts
27 through its own agency, and the government may consult
28 us. We have complete responsibility for our own open
29 market policies. If, in the course of our own open market
30 policies, we decide to sell in the market, that might



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1 counteract the short term government policy. Although
2 we feel completely responsible for our own action, and
3 also the government recognizes our own responsibility
4 there -- this all being subject, of course, to the power of
5 directive if there were a real difference of opinion
6 about monetary policy -- we would not act in the
7 market without first informing the government. So we
8 would be in touch with the government and say, "Well,
9 the conditions of the banks are such and such, and we
10 think we should make them somewhat more liquid, so
11 we have the intention of buying some short term
12 paper in the market," or the reverse. Then the
13 government would take that into consideration in
14 their instructions to their agent about his action,
15 because being two separate parties that action should
16 be co-ordinated, and we should not work against one
17 another.

18 COMMISSIONER BROWN: One final question
19 on this, and that is, this government agent, is he
20 a stock broker?

21 DR. HOLTROP: He is a government employee.

22 COMMISSIONER BROWN: He is a government
23 employee?

24 DR. HOLTROP: Yes.

25 COMMISSIONER BROWN: He is a department?--

26 DR. HOLTROP: Yes, he is really a department
27 of the government.

28 COMMISSIONER GIBSON: Do you regard fiscal
29 policy as being an important element in achieving
30 the goal of monetary policy, price stability?



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1 DR. HOLTROP: I think it has become more
2 and more important. We must realize it has become
3 more and more important also when we compare with the
4 pre-war economy and certainly with the pre-1914 economy,
5 on which all our basic and classical thinking on monetary
6 policy is still based. That was in a period when the
7 government played a small role and one in which
8 monetary policy, therefore, worked completely through
9 the private sector. Part of our basic and classical
10 thinking is based on those kinds of conditions; but
11 these conditions are not the conditions of today. In all
12 modern countries some 25 per cent of expenditure is
13 government expenditure, and it is only natural that
14 if you have notions of monetary policy and notions
15 of equilibrating the economy you should first try
16 to apply them in the government field and not make
17 the private economy adapt itself to the freaks of
18 government; but, on the other hand, if possible,
19 try to adapt government to the freaks of the private
20 economy.

21 However, I do think that government policy
22 is extremely important, and we have to think of the
23 two different ways in which government policy can be
24 important. There is the direct policy of
25 expenditure and taxation of the government; that is
26 what you would call fiscal policy. And the other way
27 is that of the methods of financing of government
28 expenditure; that is what you then would call part of
29 the debt management problems.

30 COMMISSIONER GIBSON: You call this government
monetary policy?



Committee on Education and the Labor Force
Subcommittee on Labor

Mr. [Name]

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1 DR. HOLTROP: I would call the whole
2 thing government monetary policy, yes -- monetary
3 policy as applied by the government -- but it falls
4 into these two things, because in economic theory it is
5 often said -- and we have been faced with that situation
6 in Holland also, where our professors of economics
7 insisted that the government should in its own
8 expenditure policies compensate the fluctuations in the
9 private sector, so that in a period of boom the government
10 should spend less and in a period of depression the
11 government should spend more. If you come to the
12 actual experience of these things, it appears to be
13 relatively easy to spend more in times of depression,
14 but it is quite a job for government to spend less
15 in times of boom. After all, one has to realize that
16 a large part of government expenditure is accessory
17 to the expenditure of the private sector. If the infra-
18 structure of the economy has to be taken care of by the
19 government, you cannot say, in a five-year period of
20 upward cycle, "I am not going to build roads; I am not
21 going to build harbours; I am not going to build
22 hospitals" -- et cetera. In that sense, the whole
23 idea that the government could just compensate fluc-
24 tuations in expenditure by the private sector is, in
25 my opinion, an exaggerated notion of the possibilities
26 of compensatory action by the government. The govern-
27 ment is also a going concern. Indeed, we must
28 strive for governments not exaggerating the boom and
29 not themselves blowing themselves up in the upward
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1 cycle and shrinking in the downward. But to expect
2 them to do the reverse is too much.

3 In the choice of ways of financing it is,
4 however, indeed possible that in the boom they con-
5 centrate more on the income from taxation and borrowing
6 in the long term market, even if they have to compete
7 with the private sector and pay a somewhat higher rate
8 of interest. In that indirect way they may influence
9 also the possibilities of expenditure by the private
10 sector. That is the importance of debt management.
11 In the way of choosing how to finance the government
12 it plays an important role.

13 As a matter of fact, we have, in the Netherlands,
14 been applying that policy. In the last few years, for
15 example, operating under the economic impact of what
16 had to be called a kind of imported inflation, the
17 balance of payments surplus coinciding with over-
18 exertion and over-employment in the whole economy, the
19 cry has been that the government should try to compensate
20 for this excess demand. This was not so much done
21 by the reduction of expenditure, but by long term
22 borrowing in the market without these funds being needed
23 for financing, but being used for repayment of short term
24 debt to the banking system, or for repayment of foreign
25 debt. Thus the total amount of liquidity was contracted
26 by internal action, in that way compensating the
27 expansion of liquidity resulting from the balance of
28 payments surplus.

29 One might, from an internal point of view,
30 argue whether that policy would be conclusive to inter-
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however, indeed possible that in the boom they concentrate more on the income from taxation and borrowing in the long term market, even if they have to compete with the private sector and pay a somewhat higher rate of interest. In that indirect way they may influence also the possibilities of expenditure by the private sector. That is the importance of debt management. In the way of choosing how to finance the government it plays an important role.

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1 conducive to national equilibrium.

2 In both of the senses discussed I think that
3 monetary policy of the government is an extremely
4 important factor, and that it is fundamentally a more
5 important factor than the monetary policy of the central
6 bank could be. From a quantitative point of view, the
7 powers and possibilities of government are bigger, in
8 my opinion, than the powers and possibilities of the
9 central bank. So I believe the government can do more
10 there with a positive policy than the central bank
11 on its own can accomplish.

12 COMMISSIONER GIBSON: Do you regard the co-
13 ordination between government and monetary policy as
14 being of great importance?

15 DR. HOLTROP: Very important. For a long
16 period already, in the last few years, we have tried
17 continually in Holland to co-ordinate the government
18 policy with central bank policy.

19 COMMISSIONER GIBSON: How do you co-
20 ordinate them?

21 DR. HOLTROP: By moving in the same direction.
22 We have been following a restrictive policy in the
23 field of credit expansion while, at the same time,
24 the government has been borrowing in the long term
25 market without needing the funds for expenditure.
26 So their action was positively of a deflationary kind,
27 and ours was of an anti-inflationary kind.

28 COMMISSIONER GIBSON: Do you meet frequently
29 with the minister of finance?
30



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COMMISSIONER GIBSON: Do you meet frequently

with the minister of finance?



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1 DR. HOLTROP: I meet weekly with the
2 minister of finance, so there is a constant exchange of
3 views between the bank and the minister of finance.
4 We feel this is extremely useful. We have followed
5 that tradition already since the whole after-war
6 period. We do it in a very informal way, by meeting
7 on the outskirts of The Hague for luncheon and discussing
8 current problems; and that is my main contact with the
9 minister of finance. Other contacts that take place
10 are on the level sometimes of my colleagues who have
11 to discuss special subjects and als, for example, the con-
12 tacts about the money market which are being enter-
13 tained by the responsible higher officials on both sides.



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1 COMMISSIONER HARROLD: In your section on
2 international finance or international liquidity,
3 Dr. Holtrop, you have suggested, in your opinion, there
4 is sufficient international liquidity around, but you
5 say there may be in future some question as to whether
6 there is, and you suggest there are a number of techniques
7 to satisfy anything that might occur. In other words,
8 you suggest a number of alternatives. Would you like
9 to elaborate a little on that as to what can be done
10 about this problem if it arises? For instance,
11 in our case, would you like to comment on the
12 Canadian point of view, if there is some suggestion
13 about lack of liquidity as far as the Canadian situation
14 is concerned in the international market?

15 DR. HOLTROP: I would not like to go very
16 deeply into this problem of the future of international
17 liquidity because it is a subject on which so much
18 thinking still has to be done. I do not quite see that
19 it could possibly be one of the problems you are closely
20 faced with in this commission. We talk about inter-
21 national liquidity and sufficiency of liquidity. We
22 must then think of whether generally foreign exchange
23 reserves are sufficient for the purposes of the moment.
24 If we come to the conclusion that that generally is so,
25 this, of course, does not imply that necessarily every
26 country has sufficient reserves. There always will be
27 countries that have insufficient reserves, because if they
28 start with sufficient reserves and allow themselves to
29 lose reserves they will end up with insufficient reserves.
30 However, those special situations are never an answer to



a sufficient international liquidity around, but you say there may be in future some question as to whether there is, and you suggest there are a number of techniques to satisfy anything that might occur. In other words, you suggest a number of alternatives. Would you like to elaborate a little on that as to what can be done about this problem if it arises? For instance, in our case, would you like to comment on the Canadian point of view, if there is some suggestion about lack of liquidity as far as the Canadian situation is concerned in the international market?

DR. HOLTROP: I would not like to go very deeply into this problem of the future of international liquidity because it is a subject on which so much thinking still has to be done. I do not quite see that it could possibly be one of the problems you are closely faced with in this commission. We talk about international liquidity and sufficiency of liquidity. We must then think of whether generally foreign exchange reserves are sufficient for the purposes of the moment. If we come to the conclusion that that generally is so, this, of course, does not imply that necessarily every country has sufficient reserves. There always will be countries that have insufficient reserves, because if they start with sufficient reserves and allow themselves to lose reserves they will end up with insufficient reserves. However, those special situations are never an answer to



1 the general problem.

2 On the general problem I am under the
3 impression -- and I have stated it internationally, for
4 example last year at the Vienna meeting of the
5 International Monetary Fund -- that I do not see that
6 there is a general situation -- because that is the
7 important point -- in which countries would be induced
8 to follow deflationary policies because of lack of
9 international reserves. I think it is only a very
10 exceptional condition where that would be the case.
11 From that point, I think general reserves are sufficient,
12 and certainly on the European continent none of the
13 countries at the present moment has insufficient
14 reserves. In the long run the question is, what will
15 be the demand for international reserves? What are
16 really the determinants of international reserves?
17 Really, not much close investigation work has been done
18 on this subject yet. People work on some general notions
19 of reserves having to be equivalent, for example, to
20 four months or six months imports. We do not know
21 sufficiently well, really, what the exigencies of the
22 different countries are. Even so, if it should be true
23 that, indeed, countries want to increase their reserves
24 in proportion to the increase of their national income,
25 then you have one measure of expectation of increase of
26 reserves. You might also say they may want to increase
27 their reserves in proportion to the increase in international
28 trade. That would be another measure of increase. We
29 are not sure whether one or the other prevails. At
30 any rate, this takes a long time, really, before that

creates problems. But, conceptually I agree it might create



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1 problems because if we ask how much the gold
2 production is and how great the deficits are which the
3 key currencies will be willing to run -- how big they are --
4 we have a measure of the possibility of a supply of
5 reserves for the other countries, and then you can come to
6 the conclusion that after five years or ten years, what-
7 ever it may be, there may arise a problem. My contention
8 is that it is possible to find solutions for their
9 problems and that there will always be techniques one
10 can think of, and all those sorts of techniques
11 are actually being discussed.

12 I would prefer not to elaborate on them here
13 because you would not have sufficient time and background
14 to compare the different ones. There have been
15 suggestions of creating these reserves through the
16 International Monetary Fund, or by agreements between
17 the central banks. We have recently been doing that.
18 We have created special reserves in the course of this
19 year in the hands of the International Monetary
20 Fund which have indeed increased the possibilities of
21 the International Monetary Fund to act. These are the
22 additional six billion dollars of resources. We have
23 also had suggestions brought up about the key currency
24 countries holding in the future part of their reserves
25 in the form of other currencies, which would create a
26 different situation from that which we have known in the
27 past.

28 In all these ways I think solutions can be
29 found for the problems that may present themselves, and I
30 would state that my opinion at this moment is that I do
not see there are very urgent problems there, that the
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1 at the present time does sufficiently take care of
2 the problems which we are apt to face in the near
3 future, and that we must continue to study all the
4 possibilities of elaborating this co-operation to be
5 able to face the problems that might present themselves
6 at a later date.

7 COMMISSIONER GIBSON: Dr. Holtrop, you have
8 made it quite clear that you put a high priority on
9 exchange stability. As you are aware, in this country
10 we have had a flexible exchange rate up until recently,
11 beginning in 1950 and running until very recently.

12 DR. HOLTROP: Yes.

13 COMMISSIONER GIBSON: For rather special
14 reasons, partly connected with our vulnerability to
15 large capital movements. Would you care to say anything
16 about flexible exchange rates -- whether you see any
17 place for them in special circumstances; whether in
18 a country like Canada flexibility within certain limits
19 might be reasonable?

20 DR. HOLTROP: I would like to put it this
21 way: fundamentally I am thinking in terms of fixed
22 exchange rates, and I do so perhaps with the bias
23 of a relatively small European country, neighbour
24 to many other relatively small and some larger European
25 countries with a high degree of integration of trade
26 and commerce which would be simply inconceivable to
27 maintain in a system of fluctuating rates. You could
28 not have that high degree of integration which we have
29 in Europe if all the competitive relationships might
30 be influenced any day by fluctuations in the rate of

at the present time does sufficiently take care of the problems which we are apt to face in the near future, and that we must continue to study all the possibilities of maintaining our monetary position at a later date.

COMMISSIONER GIBSON: Dr. Holtrop, you have made it quite clear that you put a high priority on exchange stability. As you are aware, in this country we have had a flexible exchange rate up until recently, beginning in 1950 and running until very recently.

DR. HOLTROP: Yes.

COMMISSIONER GIBSON: For what special reasons, partly connected with our vulnerability to large capital movements. Would you care to say anything about flexible exchange rates -- whether you see any place for them in special circumstances; whether in a country like Canada flexibility within certain limits might be reasonable?

DR. HOLTROP: I would like to put it this way: fundamentally I am thinking in terms of fixed exchange rates, and I do so perhaps with the idea of a relatively small European country, neighbour to many other relatively small and some larger European countries with a high degree of integration of trade and commerce which would be simply disastrous to maintain in a system of fluctuating rates. You could

be followed any day by fluctuations in the rate of



1 exchange. From that point of view, I might say as a
2 small European country I hardly can think in other
3 terms than in terms of a fixed rate of exchange, and
4 if you have not got a fixed rate of exchange by inter-
5 national agreement you would probably have one because
6 in the case of fluctuating rates you would as soon
7 as possible try to attach yourself to a fixed rate
8 with one of the big neighbours in which you had
9 confidence that the rate they maintained would be a
10 rate based on policies of fundamental equilibria.

11 I hesitate to express myself on the Canadian
12 case because I simply do not know enough about it. I
13 have some general knowledge, of course, of the very special
14 conditions in which Canada is situated. I do have an
15 understanding, therefore, of the difficulties. I have
16 looked upon the fluctuating rate as an exception which
17 the International Monetary Fund and the international
18 world has accepted. You have, nevertheless, maintained
19 a rather stable rate almost like a fixed parity, and
20 recently you have come into developments which have
21 led to a change in this rate, and finally to the decision
22 also to get back to a fixed rate. So, at the present
23 moment you find yourselves back into a fixed rate.

24 We mentioned this morning the fixed rate:
25 the fixed rate system, as we know it in the International
26 Monetary Fund. This system has a strong bias for main-
27 taining the rate, but it does not exclude a change of
28 rate, and the system of Bretton Woods is that in the case
29 of fundamental disequilibrium it is admissible to change
30 the rate. On the other hand, our experience has shown

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of fundamental disequilibrium in its adjustment to change

the rate. On the other hand, our experience has shown



1 how difficult it is to take that sort of decision
2 and how much that sort of decision -- even if based on
3 what you might call fundamental disequilibria -- leads
4 to reverberations and to speculative movements and
5 expectations.

6 So, fundamentally, we must try to have,
7 I think, fixed rates of exchange and adapt our
8 economies to that fixed rate. But, I do admit that
9 there may be very special conditions where it becomes
10 extremely difficult and where special problems arise.

11 I do see in your case, on the one hand,
12 the factor of the enormous influence of that one big
13 neighbour. We have also big neighbours; we have three
14 of them. The conditions in the three of them will not
15 be exactly the same at the same moment. There are
16 compensating factors in it, and that will tend to
17 make our problems somewhat easier.

18 COMMISSIONER GIBSON: There is a tremendous
19 amount of capital which may move either way at any
20 moment?

21 DR. HOLTROP: Yes, I understand that.

22 COMMISSIONER GIBSON: It is not just the
23 concern of the rate being too high, as it was a while
24 ago, but sometimes the forces tend to push our exchange
25 rate the other way.

26 DR. HOLTROP: Yes.

27 COMMISSIONER MACKINTOSH: Would your big
28 Netherlands investors, institutional and individual,
29
30



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DR. HOTTROP: Yes.

COMMISSIONER MACKINTOSH: Would your big



1 be shifting funds in and out of French, Belgian
2 and German securities?

3 DR. HOLTROP: We still operate under a system
4 of foreign exchange controls for capital movements
5 in Holland. So, we have completely liberalized current
6 movements, but for capital movements we have not yet
7 re-established complete freedom. That is to say, we
8 allow free movements of capital in the stock exchange,
9 and we allow free movement of entrepreneurial capital,
10 but we have not, for example, free movement of short-
11 term capital for corporations. So, Dutch corporations
12 cannot just shift liquidity from Holland to another
13 country. They have to apply for a license if they
14 want to hold part of their liquid means in another
15 country. Therefore, we have not the possibility of
16 sudden movements. As I say, in the stock exchange we
17 have free movement, but there we have still,
18 theoretically at any rate, the possibility of a double
19 rate. You are familiar with that system: you know
20 the notion of security sterling. As a matter of
21 principle, we still know the security guilder. For
22 several years it has been at par with the commercial
23 rate and it has almost become only a theoretical
24 possibility that you might let the rate go, but it is a
25 fact that at the present moment we still have the
26 situation that if suddenly there was an enormous
27 demand from the Dutch to buy American securities,
28 or an enormous movement for foreigners to liquidate
29 Dutch securities they are holding, we might at such a moment
30 let the security rate separate from the commercial rate.



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1 But, as I say, it has gradually become a theoretical condi-
2 tion, though it is still there.

3 The answer is that we have not been worried
4 by very big capital movements in the shifting of
5 Dutch capital to other countries. We have, in a way,
6 been somewhat worried by the shifting of foreign
7 capital to the Dutch market. We have, in a way, been
8 exporting securities to a very high extent, and therefore
9 have also, in a smaller way than you, the problem of
10 capital imports which have exceeded our real demands
11 for capital. So, the influx of capital in the form
12 of foreign buying of Dutch securities has given rise
13 to some thinking about this problem, but we have not
14 taken any measures against it. This present year it
15 has been somewhat lower than the year before, but these
16 have been movements that were in the magnitude of
17 up to one billion guilders a year, and that is quite a
18 lot of money for a country with a national income of
19 40 billion guilders. It is $2\frac{1}{2}$ per cent of national
20 income, which is comparable to the movement you have
21 experienced yourselves. That type of movement can give
22 rise to problems.

23 We have found a compensation also by the big
24 export of capital, and we have intermittently allowed
25 foreign borrowing in the Dutch market to make possible
26 also a certain additional outflow of funds. Last year we
27 had foreign borrowing to an amount of 400 million
28 guilders. So far this year we have allowed foreign
29 issues on the Dutch market in the amount of 150 million
30 guilders. So, that is a kind of compensating movement.



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1 COMMISSIONER BROWN: You have no controls
2 over the servicing of foreign capital that comes into
3 the country?

4 DR. HOLTROP: How do you mean?

5 COMMISSIONER MACKINTOSH: Payment of interest?

6 DR. HOLTROP: Oh, no; that is completely free
7 because that is current payments, of course, yes.

8 THE CHAIRMAN: I wish to thank you, Dr.
9 Holtrop, for your very impressive contribution to our
10 studies. I know I express the view of all present that
11 today we have witnessed a brilliant performance.

12 DR. HOLTROP: They are very kind words,
13 Mr. Chairman. I want to assure you it has been a pleasure
14 to have this exchange of views.

15 THE CHAIRMAN: We shall adjourn now until
16 9.15 tomorrow morning when we shall hear the submission
17 of Professor Lundberg.

18 --- Adjournment.
19
20
21
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Royal Commission on Banking and Finance

DR. MARIUS W. HOLTROP

Hearings
held at

OTTAWA

Vol.

28A

Date.

SEPT. 11, 1962



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Memorandum of evidence submitted by Dr. Marius W. Holtrop, President of De Nederlandsche Bank N.V., Chairman of the Board of Directors and President of the Bank for International Settlements, to the Royal Commission on Banking and Finance

Question 1:

Could you tell us what you believe to be the objectives of monetary policy, and how you believe these objectives are related to the goals of other economic and financial policy?

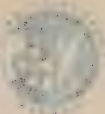
The objectives of monetary policy

(1) The primary objective of monetary policy is, in my opinion, to maintain, under conditions of reasonably full employment, the internal and the external value of the monetary unit, or, in other words, the stability of the price level and the stability of the rate of exchange.

(2) The twofold objective, thus stated, implies one of the important dilemmas of monetary policy: the possibility of authorities having to choose between giving priority to either part of the objective.

Actually, the simultaneous realization of stability of prices and of stability of exchange rates is possible only under conditions of neutrality in the outside world, and even then may run into snags. If these conditions of neutrality do not exist and if a country has to face inflationary, or deflationary pressures, coming from abroad, monetary authorities cannot, in the long run, escape the choice of giving precedence to either internal or external stability.

No a priori rule can be given as to which of the two should prevail.



Statement of testimony submitted by Dr. Martin W. H. ...
 President of the Federal Reserve Bank of New York, ...
 Board of Governors and President of the Bank for ...
 International Monetary Fund ...

Question

Could you tell us what you believe to be the objectives
 of monetary policy, and how you believe these objectives
 are related to the goals of other economic and financial
 policy?

Answer

For purposes of this hearing, I would like to state ...
 in my opinion, to maintain, as far as possible, ...
 full employment, the internal and the external value of
 the monetary unit, or, in other words, the stability of
 the price level and the stability of the rate of exchange.
 (2) The twofold objective, thus stated, implies one
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 stability of the monetary unit and the stability of the rate of exchange.
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 stability of prices and of stability of exchange rates
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 outside world, and even then may run into snags. If
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 country has to face inflationary or deflationary
 pressures, then the choice of giving
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 precedence to either internal or external stability.
 As a general rule can be given as to which of the



1 (3) Another potential dilemma of monetary policy
2 lies hidden in the presupposition of the existence of
3 a situation of reasonably full employment.

4 If such a situation does not exist this may
5 have been caused by failure or deficiency of monetary
6 policies in the past. If so, it is likely that a
7 constructive monetary policy can restore full employment
8 without compromising the stated primary objective of
9 monetary policy. It is also possible, however, that the
10 situation of under-employment is due to external causes,
11 or to internal policy mistakes in other fields than the
12 monetary one. In such a case using monetary policy to
13 try to restore full employment may very well lead to a
14 clash with the primary objective of price stability and
15 exchange stability.

16 It is for this reason that I do not include the
17 attainment and the maintenance of full employment among
18 the primary objectives of monetary policy though they
19 must, of course, be considered among the foremost
20 objectives of economic policy generally. From the
21 strictly monetary point of view, full employment has to
22 be considered as a secondary objective, that, generally,
23 ought to be pursued by monetary means only within the
24 limits set by the primary one.

25 Before reverting to the problem of the
26 relationship between aims of policy and instruments of
27 policy, I should like first to discuss the essential
28 characteristics of monetary policy.



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Before reverting to the problem of the
relationship between aims of policy and instruments of
policy, I should like first to discuss the essential
characteristics of monetary policy.



1 The essential characteristics of monetary policy

2 (4) Monetary policy consists essentially in the
3 act of exerting an influence on the present and future
4 volume of total national expenditure, by way of
5 controlling the creation of liquidity, i.e. the
6 creation of money (primary liquidity) and of near-money
7 (secondary liquidity).

8 An important subordinate function consists
9 in influencing the net import or export of capital by
10 manipulation of the rate of interest.

11 (5) In order to prevent an inflationary excess
12 of total expenditure - which would lead to overemployment
13 and an upward pressure on prices, and to a balance of
14 payments deficit, which would in the long run endanger
15 exchange stability - as well as a deflationary
16 deficiency of total expenditure - which would lead to
17 underemployment, to a downward pressure on prices and to
18 a balance of payment surplus - monetary policy must
19 strive at maintaining the flow of total expenditure at
20 an optimum level.

21 To fulfill equilibrium conditions this level
22 should be such that the part of total expenditure spent
23 abroad will equal foreign demand on the home market,
24 increased by net capital imports, and that the part
25 spent internally will just manage to buy sustainable
26 output at current prices, less exports. Thus price
27 stability, balance of payments equilibrium and there-
28 fore exchange stability, and full employment will
29 simultaneously be assured.



(4) Monetary policy consists essentially in the act of exerting an influence on the present and future volume of total national expenditure, by way of controlling the creation of liquidity, i.e. the creation of money (primary liquidity) and of near-money (secondary liquidity).

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To fulfill equilibrium conditions this level should be such that the part of total expenditure spent abroad will equal foreign demand on the home market, increased by net capital imports, and that the part spent internally will just manage to buy sustainable output at current prices, less exports. Thus price stability, balance of payments equilibrium and therefore exchange stability, and full employment will simultaneously be assured.



1 (6) The dilemmas of monetary policy, which I
2 already mentioned, result from the fact that not one
3 and the same level of total expenditure may satisfy all
4 the conditions just set forth.

5 The level of total expenditure, the domestic
6 part of which will just buy sustainable output less
7 exports, may induce a level of imports that exceeds the
8 sum total of exports and net capital imports (or the
9 amount of exports less net capital exports, as the case
10 may be) and may thus lead to a balance of payments
11 deficit. The lower level of total expenditure that
12 will reduce imports to the sum of exports and net
13 capital imports may not satisfy the condition of full
14 employment. Increasing the level of exports may
15 require a lower level of cost that cannot be induced
16 by monetary policy. Increasing net capital imports
17 may be possible by increasing interest rates but may,
18 in the long run, create balance of payments difficulties
19 by the burden of debt service.

20 Thus we must conclude that, though it is
21 easy to define the ideal set of equilibrium conditions,
22 reality will force monetary policy, even strictly
23 within the limits of its own objectives, to aim at
24 compromise.

25 The techniques of monetary policy

26 (7) The techniques available to monetary policy
27 in aiming at maintaining the conditions of full internal
28 and external equilibrium described in sub (5) consist
29 in:



and the same level of total expenditure may satisfy all the conditions just set forth.

part of which will just pay sustainable output less exports, may induce a level of imports that exceeds the sum total of exports and net capital imports (or the amount of exports less net capital exports, as the case may be) and may thus lead to a balance of payments deficit. The lower level of total expenditure that will reduce imports to the sum of exports and net capital imports may not satisfy the condition of full employment. Increasing the level of exports may require a lower level of cost that cannot be induced by monetary policy. Increasing net capital imports may be possible by increasing interest rates but may, in the long run, create balance of payments difficulties by the burden of debt service.

Thus we must conclude that, though it is easy to define the ideal set of equilibrium conditions, reality will force monetary policy, even strictly within the limits of its own objectives, to aim at compromise.

The techniques of monetary policy

(7) The techniques available to monetary policy

and external equilibrium described in sub (5) consist



1 (a) regulating quantitatively the creation
2 of money, and to a certain extent also of near-money,
3 with the purpose of directly influencing the volume
4 of total expenditure;

5 (b) manipulating the level of interest rates,
6 or the relationship between short term and long term
7 rates, particularly by working on the short term rate,
8 with the purpose of:

9 (i) influencing the public's and the
10 business community's propensity to spend,
11 with the purpose of thus indirectly
12 influencing the volume of total expenditure;

13 (ii) influencing ways of financing, both
14 active and passive, i.e. the choices between
15 borrowing long term or short term, and
16 between lending, respectively investing,
17 long term or short term, with the purpose of
18 thus influencing the volume of liquid wealth
19 held in the form of money and near-money;

20 (iii) influencing the net import or the
21 net export of capital, so as to buffer the balance of
22 payments consequences of changes in the propensity to
23 import and/or changes in the demand for exports.

24 (8) In regulating the creation of money and
25 near-money the aim of monetary policy - unless
26 considerations of external equilibrium should intervene
27 - must be to allow the creation of a sufficient volume
28 of money and near-money to compensate the net loss of
29 expenditure that will result from the joint effect of:
30



(a) regulating quantitatively the creation of money, and to a certain extent also of near-money, with the purpose of directly influencing the volume of total expenditure;

(b) manipulating the level of interest rates or the relationship between short term and long term rates, particularly by working on the short term rate, with the purpose of:

(i) influencing the public's and the business community's propensity to spend, with the purpose of thus indirectly

influencing the volume of total expenditure; (ii) influencing ways of financing, both active and passive, i.e. the choice between borrowing long term or short term, and between lending, respectively investing,

long term or short term, with the purpose of thus influencing the volume of liquid wealth held in the form of money and near-money;

(iii) influencing the net import or the net export of capital, so as to buffer the balance of payments consequences of changes in the propensity to import and/or changes in the demand for exports.

(8) In regulating the creation of money and near-money the aim of monetary policy - unless

considerations of external equilibrium should intervene - must be to allow the creation of a sufficient volume of money and near-money to compensate the net loss of expenditure that will result from the joint effect of:



(a) the spontaneous additions, held back out of the current flow of income, to the average stock of money and near-money, held by the public and the business community, that will necessarily accompany any growth of real income;

(b) the spontaneous additions to the liquid holdings of the public and the business community that will result from any drop in the economy's propensity to spend;

(c) the spontaneous withdrawals out of the liquid holdings of the public and the business community, to finance additional expenditure, that will result from any increase in the economy's propensity to spend.

(9) Though one may thus, conceptually, nicely define how monetary policy ought to exactly compensate the fluctuations in effective demand which are due to the possibility of hoarding and dishoarding money, it actually is impossible to closely observe these fluctuations. Monetary policy must therefore rely on indirect indications to judge the adequacy of current money creation. It therefore can, at its very best, only approximately succeed to maintain the flow of total expenditure at its optimum level. Fluctuations in induced investment, i.e. in inventories, in foreign exchange reserves and in actual production, will buffer the impact of fluctuations in total expenditure that monetary policy has been unable to prevent.

(10) Apart from the creation of money by external causes through balance of payments surplus - or cancellation through deficit - the actual internal creation



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(10) Apart from the creation of money by external

causes through balance of payments surplus - or cancellation through deficit - the actual internal creation



1 of money and of near-money will, generally, take place
2 by the private banking system and, possibly, by other
3 deposit-taking institutions, by way of financing some
4 part of the expenditure of the private or the public
5 sector out of deposits with a money - or a near-money-
6 character.

7 Money creation may, however, also take
8 the form of direct recourse by the Government to the
9 central bank or to the money market. Recourse to the
10 Bank would, of course, mean actual creation of money.
11 Recourse to the money market might mean money creation
12 if the banking system were taking the paper; it would
13 mean creation of near-money if the paper were taken by
14 the public.

15 (11) The power of monetary authorities to
16 regulate the creation of money and of near-money depends
17 largely on their power to control, by direct or indirect
18 means, the credit- and investment - policies of the
19 money-creating institutions. This power of control is
20 generally vested in the central bank.

21 By taking direct recourse to the money-
22 market Government can however, also exercise a direct
23 influence on the process of creation of money and near-
24 money. Likewise important is the power of Government to
25 exert a contrary influence, namely that of cancelling
26 money. It can do so by accumulating surplus out of
27 current income and using such surplus to repay debt to
28 the central bank or the banking system. It can do the
29 same by borrowing on the capital market in excess of
30 financing requirements.

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sector out of deposits with a money - or a near-money-part of the expenditure of the private or the public deposit-taking institutions, by way of financing some by the private banking system and, possibly, by other of money and of near-money will. Generally, take place



(12) It follows that monetary policy does not consist of central bank policy only. It includes that part of budgetary policy which is concerned with the choice between the financing of Government expenditure, in excess of income, from taxation, out of capital market- or out of money market-resources. It also includes that part of debt management policy which is concerned with the choice between consolidation or deconsolidation of outstanding debt.

Consequently the responsibility for monetary policy cannot be considered to be a responsibility of the central bank only. The responsibility of Government will always be involved, also in those cases where the Government does not share in ultimate responsibility for central bank policy proper.

(13) The possibility for monetary authorities to manipulate to a certain extent the rate of interest, as mentioned sub (7,b), is based on:

(a) the power of the central bank to fix the rate at which it is willing to make its own credit available to the market;

(b) the influence the central bank may exert on market conditions by its open market policies;

(c) the influence the Government may exert on market conditions as one of the principal borrowers.

(14) Manipulation of the rate of interest can be expected to influence the present or future volume of total expenditure in so far as:



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Manipulation of the rate of interest can

be expected to influence the present or future volume of

total expenditure in so far as:



(a) higher short term rates will tend to lessen demand for bank loans;

(b) higher long term rates may cause certain investment projects to become unattractive;

(c) higher long term rates will depress capital values and may for this and other reasons lessen the propensity to spend.

Lower rates can be expected to have an opposite influence. On the other hand it has to be taken into account that:

(d) higher short term rates will cause shifts from money holdings to near-money holdings, which may increase opportunities for financing additional expenditure;

(e) higher rates generally, will tend to attract foreign short term and long term capital, which will increase opportunities for financing expenditure while, at the same time, improving the balance of payments.

(15) The countereffects sub (d) and (e) lessen the usefulness of the rate of interest as an instrument of monetary policy, except that the combination of the effects sub (a) to (c) with the balance of payments effect sub (e) may precisely be desired.

(16) The fact that the restrictive effect on total expenditure of an increase in the rate of interest may be doubtful does not mean that in case of a tendency to over-expenditure an increase of interest rates could be avoided. If monetary authorities by quantitative



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(16) The fact that the restrictive effect on total expenditure of an increase in the rate of interest may be doubtful does not mean that in case of a tendency to over-expenditure an increase of interest rates could be avoided. If monetary authorities by quantitative



1 measures put a limit to the possibilities of inflationary
2 financing, the excessive demand for credit is bound to
3 lead to a rise in interest rates.

4 Such rise, which could only be avoided by
5 satisfying the excessive demand for credit, should not
6 be confounded with the rise of interest rate induced by
7 way of policy measure. It would be none but the
8 unavoidable consequence of market conditions.

9
10 The relationship between monetary policy and other
instruments of policy

11 (17) Having set forth what I believe to be the
12 main objectives and the main implements of monetary
13 policy, I may now revert to the question of the
14 relationship between the aims of monetary policy and
15 those of other economic and financial policies.

16 The aims of general economic policy
17 comprise a large number of subjects, partly economic or
18 social goals in themselves, partly conditions considered
19 to be essential for the proper fulfilment of the ultimate
20 goals. Among the ultimate goals I would mention in the
21 very first place the maximalization of wealth, a goal
22 that comprises the secondary goals of full employment
23 and satisfactory growth. The latter subject brings in
24 the problem of choice between maximalization of present
25 or of future wealth, clearly a problem with partly
26 political aspects. Among the ultimate goals one may
27 also reckon a fair distribution of income, a harmonious
28 occupational distribution, a larger or smaller degree of
29 collective provision and of public ownership, and other
30 desiderata of a social-political character on which

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also reckon a fair distribution of income, a harmonious

occupational distribution, a larger or smaller degree of

collective provision and of public ownership, and other

aspects of a social-political character on which



1 differences of opinion are obviously possible.

2 Not among the ultimate goals, but among
3 the conditions considered to be essential for their
4 fulfilment, we find the double objective of monetary
5 policy, viz. the maintaining of the stability of prices
6 and of the equilibrium of the balance of payments.

7 (18) It is exactly this fact, that the main
8 objective of monetary policy is the establishment and
9 maintenance of conditions that are in the long run
10 essential to any economic system and that are neutral
11 in respect to the pursuit of any of the possible
12 ultimate goals of social-economic policies, that sets
13 monetary policy apart from other instruments of policy,
14 such as budgetary and fiscal policy, wage and price
15 policy, foreign trade and agricultural policies, and
16 others. Most of these other instruments of policy
17 either affect the distribution of income or the
18 direction of expenditure. It is monetary policy alone,
19 that is interested in the level of income and expenditure
20 only, and not in its composition. This is, no doubt,
21 the reason why, to such a large extent, the management
22 of monetary policy can be delegated to a non-political
23 authority: the central bank.

24 Of course this does not mean that in the
25 short run the objectives of monetary policy may not
26 occasionally come into conflict with other political
27 aims. We will have the opportunity to discuss examples
28 later. It does mean, however, that in the long run the
29 objectives of monetary policy, just because of their
30 neutrality in respect to other aims, will have to prevail.



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goals. It will, however, be the duty of the central bank

to maintain the stability of prices and the equilibrium of the

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neutrality in respect to other aims, will have to prevail.



1 (19) A word might be said, in this connection,
2 about the relationship between monetary policy and growth.
3 The determinants of growth are still somewhat contro-
4 versial. Underemployed resources, level of education,
5 organizational capacity, industrial know-how, saving
6 and investment, they all have to play their role. There
7 is nothing monetary policy can add to these conditions.
8 But it is all important that once the process of growth
9 has started monetary policy should take care that the
10 internal creation of money will be sufficient to satisfy
11 the growing cash requirements that will be induced by
12 the rise of real income. If not, these requirements
13 will have to be met out of balance of payments surplus,
14 which may cause a disturbance of international relations,
15 or, if conditions do not allow for a surplus, the lack
16 of response of the monetary sector will constitute a
17 drag on potential growth.



(10) A word might be said, in this connection
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of response of the monetary sector will constitute a
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Question 2:

What methods does your bank employ to judge the appropriateness of its monetary policy in prevailing economic and financial circumstances?

The indicators of desirable monetary action

(20) It should be stated at the outset that there exist long periods during which monetary policy generally, and central bank policy particularly, do not need to be spectacularly active because deviations from the ideal situation of reasonable stability of prices, balance of payments equilibrium and reasonably full employment are not of such a magnitude that corrective monetary measures seem to be indicated. During such periods monetary policy can limit itself to taking care that no developments occur that might impede the control of future disturbances.

(21) Circumstances in which corrective monetary action is clearly indicated are:

(a) periods of boom and overemployment, of rising costs and rising prices, during which the balance of payments shows a deficit;

(b) periods of recession and underemployment, during which the balance of payments position is satisfactory.

Circumstances, on the other hand, in which, even though action might be indicated, monetary policy is faced with serious dilemmas are:

(c) periods of boom and over-employment, during which the balance of payments shows important surplus, or at least, is not unsatisfactory;



What methods does your bank employ to judge the appropriateness of its monetary policy in prevailing economic and financial circumstances?

The importance of monetary stability

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exist long periods during which monetary policy generally, and central bank policy particularly, do not need to be spectacularly active because deviations from the ideal situation of reasonable stability of prices, balance of payments equilibrium and reasonably full employment are not of such a magnitude that corrective monetary measures seem to be indicated. During such periods monetary policy can limit itself to taking care that no developments occur that might impede the control of future disturbances.

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(b) periods of recession and underemployment, during which the balance of payments position is

Circumstances, on the other hand, in which, even though action might be indicated, monetary policy is faced with serious difficulties are:

(c) periods of boom and over-employment, during which the balance of payments shows important surpluses, or at least, is not unsatisfactory;



(d) periods in which recession and under-employment coincide with balance of payments deficits.

(22) The Netherlands went through experience (a) during the Korea-boom of 1950 to early 1951, and again in the period 1956 to early 1957. They went through experience (b) in 1952, and to some extent in 1958. They finally lived through a rather prolonged period of experience (c) during the years 1960 to 1962. They never found themselves, since the last war, in position (d).

(23) In the periods mentioned above central bank policy has always been of an anti-cyclical character. In the periods 1950/51, 1956/57 and 1961/62 credit restrictive measures were taken and the Bank's discount rate was increased. In the years 1952 and 1958 restrictive measures were discontinued and the bank rate was reduced. The Government took strong compensatory actions in the years of foreign exchange crisis 1951 and 1957. Programmes of retrenchment of expenditure and increase of taxation, designed to stop inflationary developments that had occurred in the years before, were introduced in both years. Though highly effective in the years of introduction, it cannot be denied that these programmes by their after-effects added to the recessive tendencies that prevailed in the years 1952 and 1958. A compensatory monetary policy was also followed by the Government in the years 1960 to 1962, not, however, by cutting expenditure, but by delaying planned reduction of taxation and by long term borrowing in the capital



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1 market in excess of financing requirements.

2 (24) In judging the appropriateness and efficacy
3 of its own and of Government's monetary policies the
4 central bank has, of course, to keep in mind the
5 characteristics of the period under review and the
6 limitations hence created to exerting an observable
7 influence on developments.

8 In the periods clearly indicated for positive
9 monetary action the Bank will turn to the usual monthly
10 indicators of economic behaviour to judge whether
11 developments move into the desired direction. It will
12 especially give attention to (a) industrial production,
13 (b) employment, (c) foreign trade, (d) prices and wages,
14 and finally, to the one indicator that comes available
15 daily: (f) the movement of foreign exchange reserves.
16 On the other hand the Bank will not only look at results,
17 but also at factors that are indicative of direction and
18 force of the monetary influences that are being exerted
19 such as: (g) the course of Government finance, (h) the
20 development of the banking system's loans and investments,
21 and (i) the movement of the rates of interest on money
22 and capital markets. It will, as an indicator of the
23 monetary leeway still available, give attention to
24 (j) the liquidity situation of the banking system and
25 to (k) the volume of liquidity, i.e. of money and near-
26 money available to the economy. Finally, as an important
27 indicator of potential future developments, it will give
28 close attention to (l) the forecasts of the Central
29 Planning Bureau, a Government agency, that has the
30 function of analysing current economic developments,



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1 of making estimates of the likely consequences of
2 policy decisions, and of forecasting future developments
3 generally.

4 (25) In a country like the Netherlands, with
5 a turnover in foreign trade (and services) equal to
6 national income, the balance of payments is a particularly
7 sensitive indicator of internal over- or underexpenditure.
8 The marginal proportion of any increase or decrease of
9 total expenditure that will show up in larger or smaller
10 imports will always be very great.

11 This situation is very helpful in making
12 monetary policy effective in a period of internal
13 overexpenditure. For the balance of payments deficit
14 that is likely to ensue will drain the liquidity of both
15 the economy itself and of the banking system and will
16 thus tend to strengthen the impact of any restrictive
17 measures taken by the monetary authorities.

18 (26) A particularly important direct indicator
19 of the efficacy of especially central bank policy is,
20 of course, the development of the banking system's
21 active operations, i.e. of the sum total of its loans
22 and investments, as this magnitude will largely determine
23 the volume of the possible additions to the flow of
24 total expenditure, the control of which is monetary
25 policy's purpose.

26 In the Netherlands the central bank has,
27 in periods of actual or threatening overexpenditure,
28 set quantitative limits to the expansion of the banking
29 system's loans. Presently, for example, the banks
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1 not more than one half of one percent per month. In
2 case this percentage is exceeded special non-interest-
3 bearing deposits have to be made with the central bank
4 to the amount of such excess. The extent to which the
5 limits set by the central bank are complied with forms,
6 of course, an important direct measure of the efficacy
7 of the central bank's policy.

8 (27) A factor which has always had the particular
9 attention of the Bank in judging the efficacy of
10 present policies, but also, and perhaps still more,
11 in gauging the potential threat to future monetary
12 equilibrium, has been the state of liquidity of the
13 economy, as measured by the ratio between the total
14 mass of money and near-money in hands of the public
15 at large and national income.

16 By near-money, or, to use rather the more specific
17 term, by "secondary liquidity", is meant the sum total
18 of short term claims - other than money proper, i.e.
19 currency and demand deposits subject to check or
20 girotransfer - on the banking system and on the Govern-
21 ment, that are being used by the business community as
22 a liquidity reserve. Thus defined secondary liquidity
23 comprises essentially time deposits with the banking
24 system and short term Government paper held outside
25 the banks. The main characteristic of this group of
26 short term money claims is that, in case of massive
27 withdrawal, the claimants can, for all practical
28 purposes, compel the debtors to take recourse to money
29 creation in order to settle their debt. For the
30 banking system this recourse simply takes the form of



not more than one half of one percent per month. In case this percentage is exceeded special non-interest-bearing deposits have to be made with the central bank to the amount of such excess. The extent to which the limits set by the central bank are complied with forms, of course, an important direct measure of the efficacy of the central bank's policy.

(27) A factor which has always had the particular attention of the Bank in judging the efficacy of present policies, but also, and perhaps still more, in gauging the potential threat to future monetary equilibrium, has been the state of liquidity of the economy, as measured by the ratio between the total mass of money and near-money in hands of the public at large and national income.

By near-money, or, to use rather the more specific term, by "secondary liquidity", is meant the sum total of currency and demand deposits subject to check or girotransfer - on the banking system and on the Government, that are being used by the business community as a liquidity reserve. Thus defined secondary liquidity comprises essentially time deposits with the banking system and short term Government paper held outside the banks. The main characteristic of this group of short term money claims is that, in case of massive withdrawal, the claimants can, for all practical purposes, compel the debtors to take recourse to money creation in order to settle their debt. For the banking system this recourse simply takes the form of



1 crediting sight deposit accounts against debiting time
2 deposits; for the Government it means falling back on
3 the banking system or on the central bank which, under
4 the assumed circumstances, will hardly be able to refuse
5 accommodation. In this respect there exists an essential
6 difference between secondary liquidity and other supposedly
7 liquid claims and assets, which can only be turned into
8 cash in so far as the debtor holds liquid reserves or
9 has the possibility to borrow in the market, or in so
10 far as a substitute holder of the asset can be found.

11 Experience in the Netherlands has shown that
12 the ratio of money plus secondary liquidity to national
13 income varies within rather narrow limits, though with
14 rising or falling short term interest rates there may
15 be shifts between the proportion of money and of
16 secondary liquidity in the total. Roughly the mass of
17 liquidity amounts to about 45 per cent of national
18 income with money constituting somewhat less than two
19 thirds and secondary liquidity somewhat over one third
20 of the total. In periods of internal overexpenditure
21 and balance of payments deficit the total has gone down
22 to 41 per cent, in periods of recession and/or of
23 balance of payments surplus a ratio as high as 47 per
24 cent has been reached. Higher figures occurred only
25 in the years of repressed inflation of the late forties
26 and in the very early fifties. A high ratio thus gives
27 an indication of the potential loss of foreign exchange
28 that may result from contraction of the mass of liquidity.

29 It has been the constant policy of monetary
30 authorities in the Netherlands to prevent the mass of



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1 liquidity to be built up above a reasonable minimum
2 which the economy clearly wishes to hold. For that
3 reason the Government has, in the last decade, in
4 principle abstained from financing any part of budgetary
5 expenditure by short term borrowing, thus leaving the
6 necessary creation of liquidity in proportion to real
7 growth to the banking system's lending to the private
8 sector. It has, moreover, in periods of excess liquidity,
9 as the country has recently experienced in consequence
10 of balance of payments surplus, proceeded to reduce
11 liquidity by borrowing on the long term market for
12 repayment of external debt and for consolidation of
13 internal short term debt held by central bank and
14 banking system.

15 (28) In view of the specific characteristics
16 attached to the secondary liquidity holdings of the
17 economy the Netherlands Bank considers the financing
18 of expenditure out of creation of secondary liquidity
19 just as much as an inflationary form of financing as
20 its financing out of creation of money.

21 It is true that the inflationary effect of
22 such financing, that means its effect on the volume of
23 total expenditure - which effect, according to circum-
24 stances (¹), may or may not be desired by monetary
25 authorities - may be compensated ad hoc by a spontaneous
26 withdrawal of money out of the current flow of gross
27 income by the business community. Even so, that with-
28 drawal may prove to be of only a temporary nature.

29 Very easily, however, the addition to the
30 mass of secondary liquidity may come out of the activation



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mass of secondary liquidity may come out of the activities



1 of existing cash resources, and may then mean an increase
2 in the velocity of circulation of money, with no
3 compensating effect on the volume of total expenditure
4 at all. Or it may enforce a switch from time deposits
5 to sight deposits with the banking system, which would
6 mean a creation of money in which the banking system
7 would only play a passive role.

8 The Netherlands experienced a bad case of
9 this type of inflationary financing when in 1956/57
10 the municipalities, finding the capital market
11 exhausted, financed continued investment expenditure
12 by placing short term bills in the money market, which
13 were readily taken by corporate business and financed
14 out of the liquid reserves the latter had been holding
15 with the banking system.

17 (1) The term "inflationary" as used in this
18 connection has therefore no derogatory
19 connotation. It simply means: "increasing
20 the volume of total expenditure".
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1 Question 3:

2 What, in your view, are the limitations of monetary
3 policy?

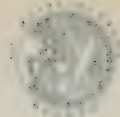
4 Limitations of monetary policy

5 (29) When speaking about the limitations of
6 monetary policy one should distinguish, in my opinion,
7 between the limitations that rightly must be set to the
8 range of objectives of monetary policy, and the
9 limitations monetary policy has to face in trying to
10 achieve these objectives.

11 (30) The answer to the first question has already
12 been given in my reply to question (1), from which it
13 appears that I believe that monetary policy must not be
14 asked to aim for more than for establishing and
15 maintaining conditions of internal and external monetary
16 equilibrium, i.e. the conditions that in the long run
17 are most conducive to the realization of full employment
18 and of sustainable growth.

19 It should not be used, and for practical
20 purposes can hardly be used without ultimately betraying
21 its true objectives, as an instrument to achieve a
22 fairer distribution of income, a more preferable
23 distribution of expenditure or a more rapid rate of
24 growth.

25
26 (31) As to the limitations monetary policy
27 encounters in the pursuit of its proper objectives, I
28 think it is useful to distinguish between three types,
29 viz.



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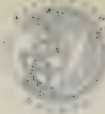


- (a) limitations of an institutional character,
- (b) limitations of an operational character,
- (c) limitations due to contradictions of purpose.

(32) Limitations of an institutional character can be due to the institutional traditions of a country or to rules and regulations set by law or statute, limiting the field of action or the instruments of policy of monetary authorities.

It would certainly go beyond the scope of this memorandum to try to give an exhaustive survey of all possible limitations of this type. They become apparent when comparing the differences of law and tradition between one country and the other. As an example of different institutional traditions one might mention:

- (a) whether the market has an automatic access to central bank credit, as in the United Kingdom, or only by way of privilege, as in the United States; (b) whether the banking system follows hard and fast rules of liquidity - and cash - ratios as in the United Kingdom, or does not; (c) whether a country knows clear functional separations between money market and capital markets and between deposit banks and saving banks or does not. As examples of legal differences one might think of: (d) whether the central bank has or has not the power to finance Government directly; (e) whether the central bank can or cannot give



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1 directions to the banking system for the conduct of their
2 (reserve requirements, credit ceilings, etc.); and (f)
3 whether the Government is or is not subject to limitations
4 as to interest policy and volume of debt.

5 (33) Limitations resulting from law and
6 tradition will not make monetary policy impotent. They
7 may, however, be rather frustrating and they certainly
8 mean that in different countries different techniques
9 have to be followed to accomplish comparable aims.

10 The limitations set by tradition are usually
11 difficult to overcome. Yet, they may be utterly
12 important, as they may for example, be decisive for the
13 possibility of choice between being restrictive by
14 limitation of accommodation, or only by increasing
15 discount rates.

16
17 Limitations of law have a slightly better
18 chance of disappearance. Laws, after all, are sometimes
19 changed, and these changes can be helpful, by the
20 introduction of new techniques, in creating possibilities
21 to bypass the limitations set by tradition.

22 For the benefit of the efficacy of
23 national monetary policies and for the benefit of
24 constructive international monetary cooperation, it must
25 be hoped that future legislation will give monetary
26 authorities the widest possible choice of instruments
27 to be used in the pursuit of their task.

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29 (34) It is particularly central bank policy
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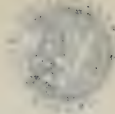
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1 Central banks and the banking system are, after all,
2 not in the business of spending and investing themselves,
3 but only in the business of making, indirectly or directly,
4 credit available to the business community and to the
5 Government. The initiative for expenditure has to be
6 taken by the borrower and the central bank can hardly
7 do more than making credit tighter when demand is large
8 and total expenditure is on the increase, or making
9 credit easier when demand slackens and total expenditure
10 tends to fall. Central bank policy can therefore only
11 to a limited extent be of a truly compensatory nature.
12 It can, in a boom, choke off the increase of expenditure;
13 it can, by doing so, even force expenditure down below
14 the inflationary level to which it had, by the use of
15 bank credit and activation of idle liquidity, risen in
16 the period before. But it cannot, for all practical
17 purposes, bring total expenditure down by actually
18 reducing the volume of bank credit during a boom, or
19 bring it up by actually increasing the volume of credit
20 during a recession.

21 It is true that, in theory, it would be
22 conceivable that a central bank might dispose of an open
23 market portfolio of such magnitude and such composition
24 that it could sell during the upward phase of the cycle,
25 sufficient paper to draw an appreciable part of current
26 savings out of the market, thus depriving the private
27 sector of means of finance and forcing it to a cut of
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1 has the power to cut or to increase its own expenditure
2 in order to compensate for fluctuations in expenditure
3 by the private sector, or to increase or decrease
4 taxation with the same purpose.

5 In this sense it is only Government policy that
6 can be fully compensatory. Central bank policy must
7 limit itself to creating the conditions in which over-
8 expenditure will automatically come to a stop because
9 it has exhausted the possibilities of inflationary
10 financing on which it feeds itself. It must also,
11 in periods of underexpenditure limit itself to creating
12 the conditions most conducive to recovering. I believe
13 that central bank policy has the greatest possibilities
14 of success in the first-named period, and Government
15 monetary policy in the second one. The best results,
16 however, will ensue when the two cooperate.

17 (35) The limitation of monetary policy that can
18 haunt authorities most is no doubt the one which results
19 from the impossibility, under certain circumstances, of
20 taking measures that will simultaneously tend to fulfill
21 the three equilibrium conditions implied by the
22 definition of the objective of monetary policy, as given
23 in paragraph (1), viz. price stability, balance of
24 payments equilibrium and full employment.

25 For the authorities such impossibility may
26 create a most vexing contradiction of purpose: they
27 must ultimately decide to give precedence to either
28 one or the other part of their joint objective. The
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1 (36) The classical case in which the causes of
2 disturbance come from abroad is that of a country that
3 by itself enjoys conditions of perfect internal equilibrium,
4 but that is being faced by a balance of payments surplus
5 (or deficit) resulting from an increased (or decreased)
6 export demand which is clearly caused by inflationary
7 (or deflationary) conditions abroad. Usually such
8 country will just have to ride out the storm and to absorb
9 the disagreeable consequences, in the expectation that
10 the countries where the monetary disturbance originated
11 will take the proper measure of rectification. But if
12 the disturbing condition continues too long, the
13 moment may come when authorities have to choose between
14 trying to maintain the internal value of their currency
15 by changing the exchange parity, or maintaining the
16 exchange rates but giving up to strive for internal price
17 stability.

18 Some of the devaluations of the thirties and
19 of the re-valuations of the period just after the war
20 may well be attributed to this dilemma.

21
22 (37) A more subtle case of monetary disturbance
23 coming from abroad is the one in which the country which
24 originally found itself in an equilibrium condition is
25 faced with a balance of payments surplus due to (a) in-
26 creased exports caused not by inflationary conditions
27 abroad, but rather by shifts of demand in international
28 trade or by (b) an inflow of foreign capital.

29 The difference with the situation discussed in
30 the previous paragraph is that from a world point-of-view



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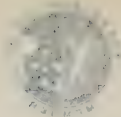
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The difference with the situation discussed in
the previous paragraph is that from a world point-of-view



1 there is no question of a monetary disturbance at all.
2 This is not the case of an increase in total expenditure
3 made possible by inflationary financing, but of a shift
4 in expenditure for goods and services in the private or
5 in the Government sector from spending in one country to
6 spending in another one. The fact of the matter is,
7 however, that these shifts present themselves from the
8 national point of view as monetary disturbances because
9 surpluses and deficits in the balance of payments
10 automatically mean that much creation or cancellation
11 of money. In the case just mentioned it will be observed
12 that in some other country or countries the reverse
13 phenomenon occurs, viz. a balance of payments deficit
14 due to increased imports of goods and services or to an
15 inflow of capital. One will also find that this balance
16 of payments deficit - otherwise than one caused by
17 monetary inflation at home - is accompanied by a falling-
18 off of total expenditure in the home market and, as a
19 consequence, by generally recessive conditions.

20 It will easily be seen that the described
21 situation is in many respects characteristic of the
22 relationship that has, for the last few years, existed
23 between continental Europe and the United States.

24 (38) In the situation to which the previous
25 paragraph refers monetary authorities in the surplus
26 country will be inclined, in defense of their internal
27 equilibrium and of the purchasing power of their
28 monetary unit, to take restrictive measures. In the
29 deficit country on the other hand, especially so long
30



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19 consequence, a monetary contraction.

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27 country will be inclined, in defence of their internal

28 equilibrium and of the purchasing power of their

29 monetary unit, to take restrictive measures. In the

30 deficit country on the other hand, especially so long



1 as the reserve situation does not look too disturbing,
2 they will be disposed to follow an expansionary monetary
3 policy, in order to correct the drop in home demand and
4 to counteract the tendency to underemployment. Thus,
5 on both sides, policies may be followed that can only
6 serve to prolong and perhaps even to reinforce the
7 balance of payments problems that both parties have to
8 face.

9
10 (39) The answer to the authorities' dilemma is
11 that the situation does not ask for this type of monetary
12 action at all. One cannot correct by deflationary or
13 inflationary measure a disturbance that fundamentally
14 has no monetary causes, and, as we have already seen,
15 the present one has not. If the shift of demand - or
16 the movement of capital - that caused the balance of
17 payments problem is of a temporary nature only, monetary
18 reserves will have to absorb the ultimate net effect.
19 If the shift is of a permanent character an adaptation
20 in the cost relationships between the surplus and the
21 deficit countries will have to create a new situation
22 of trade equilibrium.

23 This adaptation may come from the slow
24 process of increases in unit cost in the surplus country
25 - which unavoidably will bring some drop in the
26 purchasing power of money - and from some decrease in
27 unit cost in the deficit country. It may also come from
28 a change of parity on either side. This means that the
29 final solution will force monetary authorities to either
30 sacrifice the internal, or the external value of their
monetary unit.



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purchasing power of money - and from some decrease in

unit cost in the deficit country. It may also come from

a change of parity on either side. This means that the



(40) The shift of demand in international trade discussed in the previous paragraph need not be a spontaneous one. It may be the reaction to preceding differential cost developments between countries and more specifically to increases in labour cost that outstrip increases in productivity, either in a country generally, or in the important export industries of a country. It is also conceivable that such increases in labour cost lead not only to shifts in international demand, but also to shifts in national demand, thus creating partial unemployment.

It will be well to remember that also this phenomenon of "cost-inflation" or "wage-inflation", as it is often referred to, is beyond the reach of monetary policy to rectify. The price increases it may bring cannot be corrected by a restrictive policy without creating more unemployment. Nor can the unemployment be corrected by an expansionary policy without creating more balance of payment troubles.

Monetary policy is not and cannot be a cure-all. Its true limitations are that it is an instrument of policy which should be used neither for more, nor for less, than for preventing, as far as possible, and for correcting if need be, disturbances of a monetary nature only.



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Question 4:

What are the responsibilities of your bank in setting the objectives of, and executing, your government's debt management policy? To what extent do you believe debt management policy and monetary policy must be closely, if not entirely, linked together?

Debt management

(41) The technical scope of debt management in the Netherlands is more restricted than in the Anglo-Saxon countries. The main reasons are that

(a) Government follows the rule not to finance budgetary expenditure with money market resources. Consequently net money market operations are, generally, restricted to taking care of seasonal fluctuations in Government income and expenditure; and that

(b) Government borrowing on the capital market, generally, takes the form of issuing 25 to 40 year loans, repayment of which takes place by redemption spread over the life time of the loan. Consequently there are very few loans with fixed maturity and long term loans therefore do not gradually become money market material.

(42) As a consequence of the condition mentioned above sub (b) there exists a clear separation between what is considered the Government's short term debt (treasury bills and treasury notes) and its long term debt (mainly bonds) and also between the money market and the capital market. The commercial banks do not operate, generally, in the bond market. The only form of long term Government paper they hold to any important extent consists of 1,200 million guilders of 8, 10 and 12 year treasury certificates created in 1954 by way of



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1 consolidation of short term debt in the hands of the
2 banking system, and only negotiable between the banks
3 themselves. (The 1962 maturity of these certificates
4 was prolonged for another 10 years.)

5 (43) Operations of a debt management character
6 that might occur under conditions presently prevailing
7 in the Netherlands are:

8 (a) increasing long term debt in order to
9 finance budgetary expenditure;

10 (b) increasing long term debt in order to
11 repay short term debt, or, at any rate, to sterilize
12 the proceeds;

13 (c) increasing long term internal debt in
14 order to repay foreign debt;

15 (d) repayment of long term debt out of
16 current income;

17 (e) repayment of long term debt out of
18 increases in short term debt;

19 (f) increase of short term internal debt
20 to repay foreign debt;

21 (g) repayment of short term debt out of
22 current income;

23 (h) manipulation of the average maturity
24 of the short term debt.

25
26 (44) From the point of view of monetary policy
27 I consider the transactions mentioned above sub (a),
28 (d) and (f) as neutral, as they generally will not affect
29 the internal expenditure/output relationship. It is
30 assumed that capital market resources will ultimately



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Internal Finance

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- (e) repayment of long term debt out of

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- (f) increase of short term internal debt

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Monetary Policy

- (h) manipulation of the average maturity

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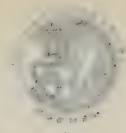


1 find their way into investment. The Government's
2 activity on the market may somewhat speed-up or slow-down
3 this process, but will in the end only affect the rate
4 of interest and not the volume of expenditure. There
5 may, however, be an indirect influence, through the rate
6 of interest, on the balance of international capital
7 movements. The transaction sub (f) will likewise tend
8 to leave the internal demand/supply relationship
9 undisturbed, but will, of course, affect the foreign
10 exchange reserves held by the authorities or by the
11 banking system.

12 (45) The transactions mentioned in paragraph 43,
13 sub (b), (c) and (g) are clearly of a deflationary, or
14 rather of a counter-inflationary, character, as they
15 tend to reduce actual or potential expenditure by taking
16 money out of the flow of savings ((b) and (c)),
17 respectively straight out of the flow of income ((g)),
18 or out of an existing stock of excess liquidity, without
19 these proceeds being fed back into the flow of expenditure.

20 The Netherlands Government has repeatedly
21 made use of these techniques to compensate inflationary
22 pressures, as for example in the late forties to
23 consolidate still existing excess liquidity, and in the
24 periods of 1953/55 and 1960/62 to compensate the
25 influence of inflow of foreign capital and excessive
26 export demand.

27
28 (46) This leaves us to account for the trans-
29 actions mentioned in paragraph 43, sub (e) and (h).
30



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(46) This leaves us to account for the transactions mentioned in paragraph 45, sub (e) and (b).



1 The first one is clearly of an inflationary,
2 or reflationary, character. It has so far never been
3 made use of in the Netherlands. Conceivably it might
4 be part of a reflationary programme in a period of
5 serious recession.

6 Transaction (h), the manipulation of the
7 average maturity of the short term debt, must be
8 considered as having a potential indirectly bearing on
9 the expenditure/output relationship, inasmuch as it
10 will affect the liquidity situation of the banking
11 system, and, to some extent also of the private sector
12 of the economy generally. In the Netherlands it takes
13 the form of influencing the average maturity of the
14 outstanding volume of treasury bills, which usually
15 run from three months to one year, and treasury notes
16 usually running from 2 years to 5 years. This short
17 term Government paper constitutes the main investment
18 opportunity on the money market. A large part of it
19 is being held by the banking system.

20
21 (47) The responsibility for debt management as
22 far as the operations of the Government are concerned,
23 lies with the Government, who acts not through the
24 Bank, but through its own agency in Amsterdam.

25 The Bank, however, has a responsibility of
26 its own for buying or selling Government paper for,
27 respectively out of, its own portfolio. The Bank
28 will transact these operations for reasons of monetary
29 policy only. It has the authority to operate in the
30 long term market as well as in the short term market,



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1 but has, so far, only operated in the money market.

2 The Bank advises the Government with respect
3 to the Government's operations. It will not operate
4 itself without previous consultation with the Government.

5 (48) Debt management, when defined in the broad
6 sense used in the foregoing paragraphs, and therefore
7 including not only the management of existing debt, but
8 also the increasing or reducing of debt, embraces all
9 the activities of Government of a monetary nature, viz
10 the creation and cancellation of money and near-money
11 and the exerting of an influence on the rate of interest.
12 It therefore includes the very essence of what I have
13 called previously monetary policy of the Government.

14 It must be clear, therefore, that I indeed
15 believe debt management, for that part of it, to be
16 entirely linked together with monetary policy in general.



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1 Question 5a:

2 Could you elaborate for this Commission your analysis of
3 the ways in which the various techniques of monetary
4 control are made effective?

4 Techniques of monetary policy

5 (49) The instruments of policy the Netherlands
6 Bank has at its disposal to make its monetary control
7 effective are:

8 (a) discount policy;

9 (b) open market policy;

10 (c) variation of cash reserve requirements;

11 (d) the giving of directions to the banking
12 system.

13 (50) The use of discount policy has two aspects,
14 viz. (a) the fixing of the rate of interest at which
15 the Bank's credit shall be available, and (b) the
16 willingness of the Bank to admit borrowers to its
17 facilities.

18 Though by tradition the rate of interest
19 charged by the banking system for its loans is for a
20 large part linked to the official discount rate, the
21 significance of the latter rate in determining the
22 volume of credit available to the economy should not
23 be overestimated. Experience does not show the demand
24 for credit to be very sensitive to the price and the
25 variations in the discount rate are not necessarily
26 linked with changes in the availability of credit to
27 the public. The banking system is not usually indebted
28 to the central bank, and when it is not, the bank may
29 have to use other means than the control of the price
30 and the availability of its own credit to exert an



Could you elaborate for this Commission your analysis of the ways in which the various techniques of monetary control are made effective?

Monetary Policy

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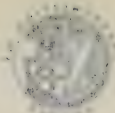


1 influence on the volume of credit.

2 (51) Nevertheless there are occasionally periods
3 during which the market has to take recourse to the
4 Bank. For such periods it is important that the Bank
5 takes the view that making use of its facilities is
6 not a right, but only a privilege that can be made use
7 of only temporarily. Thus, once the market has recourse
8 to the Bank, the latter can exert a direct control on
9 the volume of its credit.

10 This also gives the opportunity of making
11 special conditions. In 1957, for example, the Bank
12 announced penal discount rates for banks that might
13 have exceeded certain limits of credit expansion. Like-
14 wise in 1957 it made facilities to the savings banks
15 dependent upon their not making any further investments,
16 as long as they were indebted to the Bank. Finally,
17 the discountability of short term paper of local
18 public authorities is made dependent upon the volume
19 of their short term debt.

20 (52) The automatic availability of the Bank's
21 credit to the Treasury is limited to an interest-free
22 debit margin of 150 million guilders. The Bank is free
23 to buy treasury paper from the market or from the
24 Treasury directly. There exists an understanding between
25 the Treasury and the Bank that the latter cannot be
26 expected to accommodate the Treasury for the purpose of
27 financing budgetary expenditure. On the other hand the
28 Bank has been willing in many instances to finance the
29 Government for other purposes, such as repayment of debt
30 to the money market. Likewise the Bank has been willing



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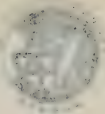


1 to finance the Treasury for drawings of guilders by the
2 International Monetary Fund and occasionally for re-
3 payment of other foreign debt.

4 (53) In principle the Bank is in a position to
5 exert an influence on the liquidity of the banking
6 system by its open-market-policy. In practice there is
7 not much room for this policy, as the open market
8 portfolio of the Bank is small - presently about 250
9 million guilders - and consists mainly of paper with a
10 maturity of less than one year. For this reason the
11 open market portfolio has mainly been used in the last
12 few years to maintain orderly conditions on the money
13 market and to buffer fluctuations in the cash liquidity
14 of the banks.

15 The fundamental cause of the limited volume
16 of the open market portfolio is to be found in the fact
17 that the gold and foreign exchange reserves the Bank
18 holds, though not representing more than about four
19 months' imports, are about equal to the banknote
20 circulation increased by the average credit balance of the
21 Government. This situation leaves only limited room for
22 holding other assets.

23
24 (54) It was this same circumstance that has led
25 in 1954 to the introduction, by gentleman's agreement
26 between the Bank, the commercial banks, the agricultural
27 credit banks and the postal giro-system, of the system
28 of obligatory cash reserves. According to this agreement
29 the Bank, taking into consideration the fluctuations in
30 the foreign exchange reserves and the causes thereof, will



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(24) It was this same circumstance that has led in 1954 to the introduction, by gentlemen's agreement between the Bank, the commercial banks, the agricultural credit banks and the postal giro-system, of the system of optional cash reserves. According to this agreement the Bank, taking into consideration the fluctuations in the foreign exchange reserves and the cases thereof, will



1 determine monthly the percentage of cash reserves in
2 proportion to deposits the banks shall hold on a non-
3 interest bearing account with the Bank. The percentage
4 shall not exceed 15. It presently amounts to 8. An
5 increase in foreign exchange reserves, which would be
6 accompanied by an increased liquidity of the banks, would
7 lead the Bank to increase the reserve ratio. A drop in
8 exchange reserves, provided it would not be caused by
9 excessive credit expansion by the banks, would lead to
10 a reduction of the reserve ratio.

11 For all practical purposes the obligatory
12 cash reserves act as an extension of the Bank's open
13 market policy. Reserve ratios have occasionally been
14 changed for purely internal reasons with no relation
15 to fluctuations in the exchange reserves.

16 (55) The Act on Supervision of the Credit System
17 of 1956 authorizes the Bank to give credit institutions
18 general directions for the conduct of their business if
19 it deems this necessary in carrying out the task laid
20 upon it in Art. 9 of the Bank Act of 1958, i.e. its task
21 of regulating the value of the monetary unit. Such
22 directions may contain provisions regarding: (a) minimum
23 liquidity ratios, (b) maximum extent of loans or
24 investments, and (c) prohibition or limitation of
25 specified types or forms of credit. Such directions
26 can be given either in agreement with the representative
27 organizations of the group of credit institutions
28 concerned, or without such agreement. In the first case
29 they are immediately effective; in the latter case they
30



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1 first need the approval of the Minister of Finance.
2 Moreover, within three months, a bill will then have to
3 be introduced in parliament, confirming them.

4 When, in 1959, as a consequence of large
5 balance of payment surpluses the liquidity of the
6 banking system became such that it would no longer be
7 possible for the Bank to effectively curb, in case of
8 need, a credit expansion by means of its open market
9 and cash reserve policies, the Bank started consultations
10 with the representative organizations of the commercial
11 banks and of the agricultural credit banks. These
12 consultations led, in 1960, to an agreement, giving the
13 Bank the power to direct the banks to limit credit
14 expansion in relation to an agreed basic period, under
15 penalty for the individual banks of having to deposit
16 with the Bank an amount maximally equal to any individual
17 transgression of the admissible ceiling provided that also
18 the collectivity of the banks would be in infringement.
19 In the summer of 1961 limits to credit expansion were
20 actually introduced. Since January 1962 the established
21 ceilings are being transgressed and 100 per cent deposits
22 are being made.

23 It is believed that the described technique
24 will enable the Bank to curb credit expansion even though
25 the liquidity of the banks and the volume of their foreign
26 assets would make them insusceptible to normal central
27 bank pressure. It is too early, perhaps, to finally
28 judge the merits of the technique, but there seems to
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(56) The Bank so far has not made use of its power to give the banking system directions regarding liquidity ratios or regarding limitation or prohibition of specified types or forms of credit. It has, however, made use of moral suasion in this direction, as when, in 1957, it asked the banks to limit their loans to the municipalities which at that time were financing investment by short term borrowing, and when, in 1955, it requested the banks to reduce their lending for investment purposes and hire-purchase financing.

(57) The paragraphs 49 to 56 having exhausted the subject of the techniques of central bank monetary policy, your question might now lead to a discussion of the techniques of Government monetary policy. It would seem to me, however, that further elaboration on this subject, after what has been said on the subject of debt management in the paragraphs 43 and following, is no longer necessary.



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1 Question 5b:

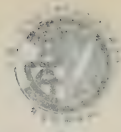
2 To what extent do you believe that the monetary
3 authorities must have control over the so-called
4 "near banks" in countries where these institutions
5 are becoming highly developed?

6 The monetary significance of near banks

7 (58) In the Netherlands the Act on Supervision
8 of the Credit System of 1956 brings all credit institutions
9 under supervision of the Netherlands Bank. By credit
10 institutions the Act means: commercial banks,
11 agricultural credit banks, security credit institutions
12 and general savings banks. By commercial banks it means
13 all corporate bodies, partnerships and physical persons
14 that to a substantial extent make it their business to
15 accept monies on deposit for their own account, and to
16 grant credits for their own account, with the exception
17 of the agricultural credit banks and the security credit
18 institutions, which are separately defined. By general
19 savings banks the Act means all corporate bodies which
20 devote themselves exclusively to the promotion of saving
21 and with that object accept monies on deposit.

22 The system of the Act means that, practically,
23 all deposit receiving institutions come under the control
24 of the Bank and that no such institution could escape
25 control if it also grants credits to a substantial
26 extent. Finance-companies and building societies do
27 not finance themselves in the Netherlands with deposits
28 but only with fixed loans.

29 (59) The Bank, according to the Act, can give and
30 actually has given, to all the institutions under its
supervision directives for the conduct of their business



Question 56:

To what extent do you believe that the monetary authorities must have control over the so-called "near banks" in countries where these institutions are becoming highly developed?

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The system of the Act means that, practically,

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of the Bank and that no such institution could escape

control if it also grants credits to a substantial

extent. Finance-companies and building societies do

not finance themselves in the Netherlands with deposits

but only with fixed loans.

(59)

The Bank, according to the Act, can give and

supervision directives for the conduct of their business



1 in the interest of the solvency and liquidity of the
2 said institutions. It also can give them, as I have
3 already mentioned in paragraph 55, directions for reasons
4 of monetary policy.

5 The fact of the matter is, however, that so
6 far the Bank has given such monetary directions only
7 to the banking system. It has not found it necessary
8 to extend them to the savings banks, because it has
9 not believed the savings banks to exert any appreciable
10 monetary influence. The monies deposited with these
11 banks can generally be considered to actually represent
12 spontaneous private savings; they are only to a small
13 extent just temporarily idle cash balances.

14 Nevertheless the Bank has observed instances
15 where savings - banks have been extending facilities to
16 their depositors which tended to give the savings
17 deposits the character of cash balances. Such facilities
18 have been accompanied with an appreciable increase in
19 the velocity of turnover of such deposits. The Bank is
20 closely studying this situation. It might consider for
21 reasons of monetary policy to subject institutions where
22 such facilities are given to more severe prescriptions
23 than other savings banks.

24
25 (60) It would seem somewhat rash to jump, on the
26 basis of Netherlands experience only, to policy
27 conclusions about a country with a very different
28 situation. Yet, I believe that the following consid-
29 erations are pertinent to the question whether "near
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monetary authorities:

(a) As long as the monies deposited with so-called "near banks" can be supposed to essentially represent spontaneous private savings only, their monetary influence can be discounted. It is true that even then they may have some stimulating influence on the velocity of circulation of money - namely in so far as deposits do not originate from current savings but from hoards of money representing old savings - but this factor may safely be neglected.

(b) As soon as the facilities, or the rates of interest, offered by these institutions, make it likely that the monies deposited with them do not represent real savings, but to a large part consist of temporary cash balances, previously held in the form of money in order to buffer the discrepancies between receipts and expenditures, their stimulating influence on the velocity of circulation of money may become important. In that case their activities assume a monetary character.

(c) This will especially be so, when the deposits, received by these institutions, do not come from private persons only, but when the institutions accept corporate deposits also.

(d) A useful indication of the monetary significance of the institutions concerned might be found in the velocity of turnover of their deposits, or of any special group of their deposits. I believe that any yearly velocity of turnover in excess of unity should be looked upon with suspicion.



Velocity of Circulation

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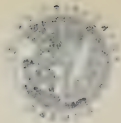
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(c) This will especially be so, when the deposits, received by these institutions, do not come from private persons only, but when the institutions accept corporate deposits also.

(d) A useful indication of the monetary significance of the institutions concerned might be found in the velocity of turnover of their deposits, or of any special group of their deposits. I believe that any yearly velocity of turnover in excess of unity should be looked upon with suspicion.



(e) It must be taken into consideration that any credit structure, based on borrowing short and lending and investing long, is liable to the risk of liquidity crisis. In case of a liquidity crisis it is only the central bank that, as lender of last resort, can offer solace. It would not be reasonable to expect the central bank to assume any responsibility for a rupture in a liquidity setup on which it would never have been able to exert any control.



Bank of Canada
Ottawa, Ontario

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1 Question 6:

2 How adequate do you believe present international
3 financial arrangements are in the light of the size and
4 distribution of international liquidity? To what extent
5 do you believe that present and prospective international
6 financial arrangements inhibit or will inhibit the freedom
7 of individual countries to pursue individual financial
8 policies?

9 International liquidity

10 (61) I believe that in the light of the size
11 of available international liquidity present international
12 financial arrangements are adequate, especially as the
13 agreement on borrowing arrangements to the amount of six
14 billion dollars for the International Monetary Fund can
15 now any day become effective.

16 As I have set forth in the Annual General
17 Meeting of the I.M.F. in Vienna, in September last year,
18 I do not believe that there presently exists a lack of
19 international liquidity. I am rather inclined to think
20 that there is too much liquidity around.

21 I do not deny that over a somewhat longer
22 period of time the problem of a sufficient supply of
23 international liquidity might arise. We do not know
24 enough, however, about the determinants of the demand
25 for international liquidity in the form of exchange
26 reserves, to be quite sure. Moreover, one can think of
27 many techniques to satisfy such demand if the occasion
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29 (62) As to the distribution of international
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(d2) As to the distribution of international liquidity there will, probably, always be reasons for dissatisfaction, since there always will be countries the reserves of which are considered inadequate in



1 comparison to their needs, calculated on the basis of
2 the fluctuations likely to occur in their balances of
3 payments, increased by some reserve for emergencies.

4 However, a country can only hold reserves
5 if it can resist the temptations of internal inflationary
6 financing, as the latter will always lead to dissipation
7 of reserves. Since there will, I fear, always be
8 countries that succumb to this temptation there will
9 ever be countries with inadequate reserves.

10 Of course, a loss of reserves may also be
11 due to other causes than internal inflation. In
12 paragraph (37) I have discussed shifts of demand in
13 international trade as one of these causes. Reserves
14 are then needed to bridge the period of time necessary
15 to carry out the policies that must lead to restoring
16 equilibrium. I believe that in most countries the sum
17 of reserves and available international monetary
18 facilities are adequate to perform that task.

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20 (63) I do not believe that international
21 financial arrangements will inhibit the freedom of
22 individual countries to pursue individual financial
23 policies, provided these policies are not of an
24 inflationary character. If they are, I think that it
25 is rightly the function of international financial
26 arrangements to restrain them. Because if they did not,
27 it would mean that a country could freely spend beyond
28 its means and yet continue to be supplied by the out-
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side world.



Present international financial arrangements imply the willingness of participating countries to freely make their currencies available in exchange of gold or dollars at a fixed rate. The possession of foreign exchange reserves, be they in gold or dollars or another reserve currency, therefore implies the power to buy without selling, that is the power to exert an inflationary influence on other countries that have to supply their currency against gold or dollars. Such power must be liable to exhaustion. No country could otherwise submit to it.

The threat of exhaustion of reserves is the ultimate incentive that will rouse countries to pursue the policies that will help to reestablish their external equilibrium. I do not think this should be felt as an inhibition of their freedom. That a country, in the long run, has to live within its means is a matter of course. Freedom lies in the choice of the means to accomplish this end.

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Question 7:

What has the experience in Holland been in maintaining a fixed, rather than a fluctuating, exchange rate, and to what extent has it limited the effectiveness of domestic monetary policy?

Fixed vs fluctuating exchange rates

(64) The Netherlands have never considered to establish a fluctuating exchange rate. In view of the volume of its international trade in proportion to national income and the measure of integration of its economy with that of the neighbouring countries, a fluctuating rate would constitute a very severe obstacle for export industries. In case of an international system of fluctuating rates, the Netherlands, in my opinion, would therefore prefer to seek a fixed parity relationship with one or more of its important trade partners, rather than to fluctuate on its own.

(65) Nevertheless the blessings of maintaining a fixed rate have not been quite unmixed, as is proved by the devaluation of 1949 and the revaluation of 1961.

Yet, both these changes of parity might also be seen as an action to maintain parity with one of the most important trade partners - in the one case the United Kingdom, in the other Germany - the parity with whom, at the moment of decision, was considered more important to maintain than the parity with the rest of the world.

(66) Maintaining a fixed rate has no doubt involved the Netherlands authorities in the dilemmas of monetary policy discussed in the paragraphs 35 and following.



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1 When the difficulties in maintaining parity
2 come from the inside - i.e. when a country is faced with
3 a serious balance of payments deficit due to internal
4 inflationary conditions, or with a surplus due to the
5 prevalence of deflationary factors - they always
6 enhance the effectiveness of monetary policy. Nothing
7 is easier for a central bank than to follow restrictive
8 policies when the banks are anyway drained of liquidity
9 by a balance of payments deficit, or to follow a policy
10 of ease when there are no external worries and the banks
11 are flush.

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13 But it is different when the problems come
14 from the outside and when boom and surplus, or recession
15 and deficit, combine to bedevil the authorities. Under
16 these circumstances the fixed parity no doubt sets a
17 limit to the effectiveness of a monetary policy that
18 would prefer to aim at internal equilibrium only. This,
19 however, is the price that has to be paid for inter-
20 national cooperation. It is also the reason why, these
21 days, all countries are so intensely involved in the
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1 Question 8:

2 Could you describe for the Commission the nature of the
3 contacts between your bank and the various capital market
4 institutions on the one hand and the public generally on
5 the other hand?

6 Public relations of the Bank

7 (67) The main instrument of communication of the
8 Bank with the public generally is the President's
9 Annual Report, a 200 page document, published around the
10 end of the month of April. This report contains a
11 thorough and statistically documented analysis of
12 internal economic and financial developments during the
13 past year, in which the emphasis is laid on the
14 significance of these developments for the internal
15 and external monetary equilibrium. The report explains
16 policy measure the Bank may have taken; it also freely
17 comments on those aspects of Government policy that are
18 believed to have a bearing on that twofold objective
19 with which the Bank in the end concerns itself: viz.
20 the stability of the internal and of the external value
21 of the monetary unit.

22 The Bank's report gets a great deal of
23 attention in the press. I believe it to have been a
24 factor in helping to keep monetary policy out of
25 political controversy.

26 (68) Apart from the Annual Report contacts with
27 the general public are of an incidental nature. In
28 periods of great stress, when rather drastic measures
29 had to be taken, I have commented on them in press
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1 Press communiqués are published occasionally
2 to summarily comment on any measures of importance, such
3 as changes in the discount rate, changes in cash reserve
4 requirements, arrangements with respect to measures of
5 credit restriction, or on important mutations in the
6 Bank's weekly balance sheet.

7 It is rare that members of the Bank's
8 governing board make public comments on policy matters.
9 Just recently, however, I commented for the first time
10 in a television interview on some points made in the
11 latest Annual Report.

12 (69) An instrument of indirect public relations,
13 the significance of which should not, in my opinion,
14 be underestimated, consists in the Bank Council.

15 The Bank Council is a body of seventeen
16 members, created by the Bank Act of 1948, that mainly
17 acts in an advisory capacity to the Minister of Finance
18 in all matters concerning the Bank's monetary policy.
19 It convenes at least six times a year, under the chair-
20 manship of the Bank's Royal Commissioner. The President
21 of the Bank reports to the Bank Council on the general
22 economic and financial situation and on the policies
23 pursued by the Bank.

24 The important feature of the Bank Council
25 is its composition. Apart from the Royal Commissioner
26 its members are: four members of the Bank's Board of
27 Commissaries, designated by that Board, and twelve
28 members, appointed by the Crown from nominations to be
29 made by designated representative organizations in such
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1 a way that there shall be two representatives each of
2 commerce (inclusive of transport), industry and
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4 labour organizations, and three experts on finance
5 and banking.

6 The Bank Council gives the governing board
7 of the Bank a unique opportunity of explaining ends and
8 means of monetary policy to top-representatives of the
9 economic community. I am happy to say that, for example,
10 the three presidents of the three central labour organ-
11 izations are presently members of this body.

12 (70) As to the contacts with financial institutions
13 the Bank entertains, as a matter of course, regular
14 formal contacts with the representative organizations of
15 the commercial banks and of the agricultural credit
16 banks. These contacts are, moreover, necessitated by the
17 provisions of the Act on the Supervision of the Credit
18 System of 1956, which foresee that the Bank shall not
19 make use of its regulatory powers without first having
20 tried to reach agreement with the representative
21 organizations of the banking community. These contacts
22 give, of course, ample opportunity of explaining the aims
23 and of discussing the expected consequences of intended
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25
26 Beside the formal contacts there are
27 frequent informal contacts both with bankers individually
28 and with the daily governing board of the bankers
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30 Formal contacts also exist with the



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8 organizations of the life insurance companies and of the
9 corporate pension funds, arrangements have been made
10 for the quarterly supply of information regarding their
11 operations.

12 (71) Already since the thirties the Bank has
13 entertained special contacts with higher education by
14 allowing one of the members of its staff, later one of
15 the members of its managing board, to hold an extra-
16 ordinary professorship in the Netherlands School of
17 Economics at Rotterdam. A deputy managing director
18 presently also holds an extraordinary professorship
19 in the faculty of economics of the University of
20 Amsterdam.

21 I think I may say that these contacts
22 have been mutually advantageous. They have been greatly
23 helpful in bringing central bank thinking in close and
24 reciprocal contact with the academic world.

25
26
27
28 Amsterdam, 10th August 1962.

29 (M. W. Holtrop)
30



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Royal Commission on Banking and Finance

PROFESSOR LUNDBERG

Hearings
held at

OTTAWA

Vol.

36

Date.

Sept. 12, 1962



Official Reporters
J.J. Nethercut and R.J. Young
Toronto, Ont.



ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Wednesday,
September 12th, 1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary



General Manager of Ontario,
Quebec, or Massachusetts,

The Hydroelectric Power House
General Manager of Ontario

Mr. W. Thomas Brown, M.P.E.
Investment Dealer
Vancouver, British Columbia

London, Ontario

Mr. Gordon L. Harold
Agricultural
Calgary, Alberta

Mr. Paul H. Brown
Montreal, Quebec

Dr. A. A. Macdonald
Vancouver, British Columbia



Ottawa, Ontario,
Wednesday,
September 12, 1962.

--- AT 9.20 A.M. THE HEARING RESUMED:

THE CHAIRMAN: I call the meeting to order.

We have present today Professor Erik
Lundberg, professor at the University of Stockholm
and economic advisor to the Skandinaviska Banken.
We appreciate very much your presence with us this
morning, Professor Lundberg, and we are looking for-
ward to the discussion which no doubt will take place,
and I wish to thank you for devoting so much time
in order to be of assistance to us. After the
last two or three days I am sure you are familiar
with the sort of discussion that is likely to ensue.

PROFESSOR LUNDBERG: Thank you very much,
Mr. Chairman. I feel very honoured to be called
upon, and I hope I shall be of some slight use to
you.

THE CHAIRMAN: Do you prefer to make an
opening statement?

PROFESSOR LUNDBERG: No, Mr. Chairman. I
have made my submission.

THE CHAIRMAN: We have your submission. We
will proceed then with the questions.

COMMISSIONER GIBSON: Mr. Chairman, may I
ask a few questions? I have, as the other Commissioners
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1 I might start out the discussion would be to ask you
2 something about your views on the objectives of
3 economic policy. You say in your memorandum that
4 there is a fundamental similarity in targets of
5 economic policy as between Sweden and Canada, in
6 that they include full employment, price equilibrium,
7 balance of payments, and stable and rapid economic
8 growth. You point out in your memorandum that
9
10 prices have risen a bit more in Sweden than in Canada.
11 You had less of a balance of payments problem, which
12 is very interesting in view of your record in prices.
13 You have had less unemployment and you have had a
14 more stable rate of growth, and a considerably greater
15 rate of growth in the last few years. Now, I take
16 it that it is your view that these differences
17 reflect different conditions, which is certainly
18 the case as we will agree. Would you think to some
19 extent they also reflect a different emphasis of policy?

20 PROFESSOR LUNDBERG: Yes, I think that is
21 a correct conception of our aims. I have not in
22 my memorandum discussed much of the conflicts between
23 the different targets that have been set up. The
24 only target in Sweden that was set in the 1920's was
25 the main target of stability of the price level and
26 that policy target was preserved during the 1930's.

27 After the war in the preparation for the
28 development during the post-war period -- during the
29 last years of the war -- full employment targets
30 became something new that was taken up as an aim of



I might start with the discussion would be to ask you something about your views on the objectives of economic policy. You say in your memorandum that there is a fundamental similarity in targets of economic policy as between Sweden and Canada, in that they include full employment, price equilibrium, balance of payments, and stable and rapid economic growth. You point out in your memorandum that prices have risen a bit more in Sweden than in Canada. You had less of a balance of payments problem, which is very interesting in view of your record in prices. You have had less unemployment and you have had a more stable rate of growth, and a considerably greater rate of growth in the last few years. Now, I take it that it is your view that these differences reflect different conditions, which is certainly the case as we will agree. Would you think to some extent they also reflect a different emphasis of policy?

PROFESSOR LUNDSTRÖM: Yes, I think that is a correct conception of our aims. I have not in my memorandum discussed much of the conflicts between the different targets that have been set up. The only target in Sweden that was set in the 1920's was the target of stability of the price level and that policy target was preserved during the 1930's. After the war is the prescription for the development during the post-war period -- during the last years of the war -- full employment, wages



1 very high priority. Then the stability of the price
2 level was taken seriously, too, but as I understand the
3 discussion, full employment became the priority aim --
4 the highest priority. The Swedish government could
5 not tolerate any unemployment, or, at least, unemployment
6 of the type we had during the 1920's and the
7 1930's.

8 A little later growth problems became
9 common all over the world. It was more or less
10 implicit in the reasoning that if you aim at high or
11 full employment and you have industrial development
12 then growth follows more or less automatically. As
13 I say in my memorandum, we have had less anxiety about
14 growth than most other countries. There has not
15 been any serious criticism of the policy of the govern-
16 ment to the effect that it has retarded growth, as,
17 for instance, there has been in the United Kingdom.
18 How we emphasize the different targets of policy is
19 determined by the different kinds of situations we
20 run into.

21 The unemployment prospects at the end of the
22 war made it appear that full employment or high employment
23 should be a primary aim of economic policy during the
24 first years of the post-war period. As in many
25 other countries, brilliant economists forecasted a
26 great depression after the end of the war, so we, as did
27 many other countries, prepared to meet that depression
28 and see to it that this unemployment would not occur.
29 High employment or full employment became of the
30 highest priority, and the price level from that point



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at priority, and the price level from that point



1 of view became of secondary importance because if
2 there are prospects of a depression then the price level
3 will take care of itself.

4 COMMISSIONER GIBSON: Would you say the
5 emphasis changes as a result of fifteen years of very
6 high employment and rising prices?

7 PROFESSOR LUNDBERG: Yes, I would say that
8 is correct, because the priority emphasis that we give
9 is very much determined by the current problems and
10 the forecast about the future.

11 During the time from, say, the Korean crisis,
12 there has been much criticism of the government for
13 not carrying out a policy for the stabilization of
14 the price level, but because we have followed an energetic
15 policy directed towards full employment the stabilization
16 of the price level has been neglected. This
17 stabilization has not been taken as a severe problem,
18 and therefore the policy discussions and the criticism
19 of the government -- not least from the side of the
20 economists -- has been directed towards its policy of
21 stabilizing the price level.

22 In general political discussions there have
23 been strong orations about the importance of stabilizing
24 money and things like that, but when we come to matters
25 of fact and the government has to deal with the pressure
26 groups in an economy like that of Sweden then this
27 problem of the price level is always very much pushed
28 into the background.

29 Problems have to be solved, and the way of
30 solving severe problems in regard to income distribution,

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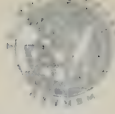


1 and problems with respect to management, in general
2 tend to go in an inflationary direction. With the lips
3 one confesses that price stability is very important,
4 but when one gets down to actual behavior and policy
5 then it does not get that kind of high priority.

6 I do not think we are unique in this respect.
7 The stabilization of the value of money is a high
8 priority aim, and we confess ourselves to that aim,
9 but in the actual practical procedures of solving
10 current problems of the economy the price level problem
11 has necessarily to be put in the background. On
12 the other hand, we always hope that more attention will
13 be paid to it than has been paid to it during most of
14 the post war period.

15 Thanks to the general international
16 surroundings of Sweden and especially the fall in raw
17 material prices, and more balanced world markets, during
18 the last few years the price level in Sweden has become
19 more stable. I do not think that is an effect primarily
20 of government policy, but is the effect of export and
21 import prices being more stable than they have been during
22 the first ten or fifteen years of the post-war period.
23 On the other hand, you can always say that you can imagine
24 such mismanagement of policy on the part of the
25 government, so/stable world market prices there had
26 occurred internal inflation in Sweden. From this point
27 of view the government policy of stabilization was
28 relatively successful.

29 I think, in answer to your question, that
30 the problem of stabilizing the value of money has



U. S. DEPARTMENT OF THE TREASURY
WASHINGTON, D. C.

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1 always been considered in the discussions. It has
2 been an aim or a target of high priority, but in
3 the actual deeds and in the actual policies carried
4 out it has been more or less neglected.

5 COMMISSIONER GIBSON: Do you make a
6 distinction in setting objectives in Sweden between
7 what are the objectives of economic policy and what
8 are the objectives of monetary policy? In other
9 words, would you have a narrower field of targets
10 for monetary policy than you would have for your
11 general economic policy?

12 PROFESSOR LUNDBERG: No, not nowadays.
13 There was a time when it was supposed -- that was
14 especially the fact during the 1930's, and perhaps
15 in some quarters after the war -- that monetary
16 policy -- I am referring to the policy of the central
17 bank especially -- referred especially to the price level.
18 That was an old tradition. It was also supposed
19 that fiscal policy and other policy measures referred
20 to employment and growth.

21 During the last ten years, anyhow,
22 there has been no question of making a division as
23 between the policy measures towards achieving
24 stabilization of the value of money, and those policy
25 measures especially directed to other targets. We
26 take the whole arsenal of policy weapons as a unit,
27 more or less, and we try to discuss the effects of the
28 whole conglomerate of policy measures on these different
29 targets.

30 COMMISSIONER GIBSON: This implies a high



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1 degree of co-ordination, but I think we will be asking
2 you questions about that later on in regard to
3 central bank relations with government, and so on.
4 Would you care to say a word or two about how Sweden
5 can achieve equilibrium in her balance of payments
6 with a substantial average annual price increase?
7 This seems like quite a remarkable achievement.

8 PROFESSOR LUNDBERG: Yes. As I say in my
9 memo, it is a problem. I think it is easier to explain
10 how and why a country gets into an exchange crisis,
11 and more difficult to explain why it does not, because
12 exports and imports are just marginal parts of the whole
13 development of the economy.

14 For example, since 1950, or over the past
15 twelve years, the value of Swedish imports has increased
16 by about four times in terms of value. That is partly
17 a consequence of the rise in prices, and also a
18 consequence of the fact that volume of imports tends
19 to rise more rapidly than the real gross national
20 product. There is a rather high marginal propensity
21 to import. During this period of full employment
22 our real national income has been rising by about 3 - 4
23 per cent per year but volume of imports have tended
24 to rise by about 40 per cent more. There is a clear
25 tendency for imports to rise more rapidly than the
26 national income. So, if you have an increase in
27 value of imports of 400 per cent it must be very much
28 a matter of luck that export values have increased
29 about four times also. There is a mechanism of
30 some kind that sees to it that this happens. If it



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1 did not happen we would have had exchange crises.

2 There is a great difference between Canada
3 and Sweden in that Sweden has a big plus in its income
4 from shipping. Shipping is a big plus item in our
5 balance of payment and it also has increased by about
6 four times. So, over this period the current balance
7 of payments has just evened out with some surplus.

8 I don't consider this as an effect of very
9 good policy, it is partly good luck. When you look
10 at Swedish exports, and we have been studying them
11 rather closely -- and here I refer to shipping and
12 engineering products such as telephones, machines of
13 all kinds, electrical equipment and refined steel
14 products -- you find that demand for such products in
15 Western Europe, and in most of the world has high
16 income elasticity. When compared with the industrial
17 production of the O.E.C.D. countries we find that an
18 increase by one percent of production is accompanied
19 by an increase in demand for Swedish exported products
20 of this kind by 1.4 per cent. That is what we call
21 an income elasticity of 1.4. So, the demand for
22 these products increased 40 per cent more rapidly
23 than production in these countries. The explanation
24 of why the value of Swedish exports has risen more
25 quickly than national income has reference to this
26 part of our exports with a very high income
27 elasticity.

28 COMMISSIONER GIBSON: In other words, your
29 machinery exports have been very much in demand lately
30 -- more so than your basic raw materials.



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28 COMMISSIONER GIBSON: In other words, your
29 machine exports have been very much in demand lately
30 -- more so than your basic raw materials.



1 PROFESSOR LUNDBERG: Yes. There is also iron
2 ore. Up to the last few years there has been a high
3 elasticity of demand in this field also. It has
4 been responding very much, and so has wood products
5 such as paper and pulp up to the last few years.
6 There is now some stagnation of demand in that field.
7 With regard to textile products we have also had some
8 expansion of exports. It is only in timber goods
9 and agricultural products that the demand has been
10 slight.

11 COMMISSIONER GIBSON: Getting back to
12 objectives again, do you think there is any essential
13 conflict between high employment and stable
14 prices?

15 PROFESSOR LUNDBERG: Yes, I do. We are
16 certainly very much aware that there is a clear clash
17 of objectives here. Of course, our prime minister
18 and finance minister can talk about these conflicts
19 in such a way that you will not recognize them. But
20 they are certainly very much aware of such conflicts.

21 The background of this is, of course,
22 that when we in Sweden have full employment or high
23 employment with, say, one per cent unemployment --
24 such a situation really means an excess demand for
25 labour in many fields of the economy, so that we
26 have more vacancies than job seekers. In the growth
27 industries especially there is a great pressure for
28 more workers, especially skilled workers. As we have
29 a piece-rate system of wage payments to a greater
30 extent than other countries this means that new piece-



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that when we in Sweden have full employment or high employment with, say, one per cent unemployment -- such a situation really means an excess demand for labour in many fields of the economy, so that we have more vacancies than job seekers. In the growth industries especially there is a great pressure for more workers, especially skilled workers. As we have a place-rate system of wage payments to a greater extent than other countries this means that new place-



1 rates have to be worked out more or less continuously
2 on the spot in these engineering shops. There is
3 a high demand for skilled labour, and there is
4 competition between the corporations so that when new
5 machinery with higher productivity is installed labour
6 gets a large part of the benefit. This process brings
7 about what we call a wage slide going on under these
8 conditions.

9 Such wage slides contribute to the rapid
10 increase in wages under full employment and are
11 transmitted also to time rate workers and other
12 branches of activity. Sweden has an almost perfectly
13 organized economy. There is hardly any single
14 citizen in our country who does not belong to some kind
15 of organized group, a trade union, an employers'
16 organization or a farmers' union, and all these groups
17 see to it that the income of their members does not lag
18 behind the general development.

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1 The result from this type of full employment is thus a
2 strong pressure for rising incomes coming from rising
3 wages in the growth industries and transmitted over the
4 economy.

5 COMMISSIONER GIBSON: That is partly how
6 you define full employment. When you said one per cent,
7 you said this was over-full employment?

8 PROFESSOR LUNDBERG: Yes, in important sectors
9 of the economy. But there are always people going away
10 from one job to another. There are always at the same
11 time sectors of the economy and corporations that cannot
12 expand or stagnate and release workers being unemployed for
13 a time; and the one per cent is as a result of the
14 process.

15 COMMISSIONER GIBSON: The full employment per-
16 centage, would it be as much as 3 per cent unemployment?

17 PROFESSOR LUNDBERG: No. There are degrees,
18 of course.

19 COMMISSIONER GIBSON: As a reasonable target,
20 a figure over which you should be concerned?

21 PROFESSOR LUNDBERG: As I said in my memo,
22 when we experienced the recession in 1958-59, during
23 the winter-time we reached about 4 per cent, and that was
24 considered very bad. The government really got a feel of
25 the strong reaction from labour, from the trade union
26 people. Even the Liberal and Conservative parties took
27 the opportunity of criticizing the government for lags
28 in policy. As I say, that was during the winter-time,
29 where there is always some seasonal slack.

30 What I would like to add is that during the



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PROFESSOR LUNDBERG: As I said in my memo, when we experienced the recession in 1950-52, during the winter-time we reached about 4 per cent, and that was considered very bad. The government really got a feel of the strong reaction from labour, from the trade union people. Even the Liberal and Conservative parties took the opportunity of criticizing the government for lax in policy. As I say, that was during the winter-time, where there is always some seasonal slack.

What I would like to add is that during the



1 recessions we have had, in 1954, 1958 - 1959 --- when
2 we had unemployment up to 4 per cent -- then the rate
3 of increase of wages was slower and the price level
4 increase was down to one per cent per year, or something
5 like that. So that we can see a clear relationship
6 between degree of full employment and wage and price
7 development. That is to say, if we tolerated 4 per
8 cent unemployment and we could pay the unemployed
9 reasonably well, so there was not too much dissatisfaction,
10 then we would perhaps be able to stabilize the price
11 level.

12 COMMISSIONER GIBSON: You would not feel, in
13 those circumstances, with a 4 per cent unemployment rate,
14 there was nearly the same conflict? As you know, there
15 has been quite a lot of talk to the effect that full
16 employment and price stability are not in conflict, but
17 most of that kind of thinking has been revolving around
18 unemployment being not more than 4 per cent -- this sort
19 of percentage.

20 PROFESSOR LUNDBERG: I agree that the conflict
21 would not be so apparent at that level in Sweden if that
22 unemployment rate was accepted as sufficiently low. I do
23 not know what would be the result in this country. This
24 degree of full employment -- and you must speak of
25 degrees here -- is not the only factor however. We have
26 noticed that during periods when there is very hard
27 competition in the export field as to imports to Sweden
28 then the possibilities and the powers of resistance against
29 demands for wage increases of employers are much stronger
30 than in periods of international inflation.



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PROFESSOR LUNDHOLM: I agree that the conflict would not be so apparent at that level in Sweden as that unemployment rate was accepted as sufficiently low. I do not know what would be the result in this country. This degree of full employment -- and you must speak of degrees here -- is not the only factor however. We have noticed that during periods when there is very hard competition in the export field as to imports to Sweden then the possibilities and the powers of resistance against demands for wage increases of employers are much stronger.



On occasions during the last few years the export employers' association has put up much of such resistance, because they knew, or thought they knew, they could not really compensate themselves for higher wage costs under the world competition conditions. The trade union people are also aware of such difficulties. The engineering industry is, to a large extent, an export industry; about one-third of production is exported. The export industries will be very much influenced by the fact that they have or will have difficulties in selling their products, and they therefore must put up strong resistance to wage pressure. You can have full employment even under such conditions, when the world market is not inviting to inflation.

As a contrast, I may tell you what happened when the opposite conditions prevailed during the Korean crisis. It was said that our trade unions behaved responsibly when faced with this situation. At the end of 1950, when the Korean boom was going on, the trade union economists made a forecast -- I think it was quite reasonable -- that the cost of living in Sweden would rise by about 10 per cent during 1951. The trade union economists maintained that such a rise of consumer prices was not something that they had to carry. The Swedish economy was prosperous and the terms of trade were rising rapidly as well as productivity. From this point of view there was no reason why the workers should be punished, and have lower real wages, because of expected price increase. The origin of the rising cost of living came from abroad in the form of rising import and



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1 export prices. The problem was to calculate how much
2 increase in wage rates was necessary in order to compen-
3 sate for the expected rise of consumer prices. The
4 calculators wanted to find out what increase in wages
5 would be necessary to give the workers, in general, an
6 increase of real wages after taxes -- something comparable
7 to the expected increase in productivity of the Swedish
8 economy. In order to do that they had also to find out
9 what would be the repercussions of the increased wages
10 on the price level. It was just to put down an equation,
11 and solve it to find out what should be a reasonable
12 increase of wage rates, to give workers a real wage
13 increase corresponding to about four per cent. In
14 actual fact the result was about 20 per cent increase
15 of wages, and in this way the workers just hardly
16 covered the actual increase in cost of living.

17 Under these conditions the unions carried out
18 a responsible wage policy and the entrepreneurs put up
19 very little resistance -- because the export boom was
20 tremendous, particularly with regard to wood and pulp
21 products. So we had two years of a rise of over 20
22 per cent per year in wages -- -- in 1951 and 1952 --
23 with only a moderate rise in real wages as a result.

24 In contrast to this situation we have had
25 no inflationary impulses from abroad in the last few
26 years, when exports were not booming, and when from
27 Japan, Western Germany and also the East there was very
28 heavy competition in many fields. Then the exporters'
29 association will put up a very heavy resistance, even
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export prices. The problem was to calculate how much increase in wage rates was necessary in order to compensate for the expected rise of consumer prices. The calculators wanted to find out what increase in wages would be necessary to give the workers, in general, an increase of real wages after taxes -- something comparable to the expected increase in productivity of the Swedish economy. In order to do that they had also to find out what would be the repercussions of the increased wages on the price level. It was just to put down an equation and solve it to find out what should be a reasonable increase of wage rates, to give workers a real wage increase corresponding to about four per cent. In actual fact the result was about 20 per cent increase of wages, and in this way the workers just barely covered the actual increase in cost of living.

What then was the result of this calculation? A responsible wage policy and the entrepreneurs put up very little resistance -- because the export boom was tremendous, particularly with regard to wood and pulp products. So we had two years of a rise of over 20 per cent per year in wages -- in 1951 and 1952 -- with only a moderate rise in real wages as a result. In contrast to this situation we have had no inflationary impulses from abroad in the last few years, when exports were not booming, and when from Japan, Western Germany and also the East there was very heavy competition in many fields. Then the exporters' association will put up a very heavy resistance, even when there is full employment, and the wage rise will



1 be dampened. This means that it is a question of the
2 degree of employment, but also the general international
3 situation which determines the development of Swedish
4 wages and prices.

5 COMMISSIONER GIBSON: Would you care to put
6 any quantitative measures on what are appropriate
7 objectives of economic policy? In other words, when
8 you talk about employment and you talk about a one
9 per cent unemployment rate, and there has been some
10 reference to 4 per cent, what is a tolerable maximum level
11 of employment as a national objective? What is a
12 tolerable annual price increase? Would you care to
13 say anything along those lines? What is a desired
14 growth rate? This is a way of sort of putting
15 priorities on objectives, if you like.

16 PROFESSOR LUNDBERG: These are really hard
17 questions.

18 COMMISSIONER GIBSON: I know.

19 PROFESSOR LUNDBERG: I do not know how
20 interesting my answers would be, because I am just an
21 irresponsible, single professor. It would be much
22 more interesting to have the pronouncement from a
23 central bank head -- although he would not answer,
24 perhaps. But I would like to take up your question
25 from the point of view that, first, when you asked for
26 what I would consider a reasonable rate or a target for
27 full employment, that question has to be answered from
28 the point of view of what kind of labour market policy
29 is being carried out in the country. I have written
30 a little about that in the memo. Economic development



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1 is always uneven. If you look at the growth of the
2 total economy you will find that most of the growth is
3 determined by a minority of corporations and firms
4 and branches of activity. It is those growing and
5 rapidly growing branches of activity being far above
6 the average, that carry the economy forward. So the
7 unevenness of growth means that there are branches of
8 activity that are rapidly expanding the demand for
9 labour; and there are, on the other side, industries
10 that are stagnating and pushing labour out of employment.
11 So the tolerance of unemployment you could have very
12 much depends on the mobility of labour and other
13 resources. If you imagine an ideal labour market
14 policy, where we have effective labour exchanges making
15 people able to move very quickly and find housing
16 accommodation in the places where growth occurs, then
17 you can always see to it that these branches of the
18 economy which are expanding rapidly are continuously
19 fed with new labour from contracting industries. Under
20 such ideal conditions you can carry out a policy with
21 a very low rate of unemployment -- below one per cent
22 and close to zero, if the policy were perfect. But if
23 you have long distances in the country and low efficiency
24 in labour market policy and coal mining in the country
25 -- and I think that is one of the happy states of the
26 Swedish economy, that we have no coal mines -- then
27 you get a sluggish mobility. In the stagnating
28 industries people will not and do not move and do not
29 like to be trained in new skills, and so on. If
30 you have a policy that does not help very much in people



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1 moving from contracting to expanding industries, then
2 the excess demand from the developing industries may be
3 dangerous and inflationary, and you have to tolerate
4 a much higher rate of unemployment in order to avoid
5 inflation.

6 So, I would answer your question with an
7 answer that is typically professorial, by complicating
8 the problem and referring it to such other factors.
9 But in the Swedish economy we aim at making or creating
10 a labour market policy, improving it to such an extent
11 resulting in such high mobility of labour and
12 vocational training, that we would be able to keep
13 the unemployment rate at one or one and a half per cent
14 without danger of too much wage pressure.

15 It is quite interesting to note that in the
16 autumn, by policy measures, the Swedish have created a
17 building boom, especially in the south and middle south
18 of Sweden with a great excess demand for labour. But
19 the labour market board now tries, and is quite effective
20 in transferring workers from the north -- where there
21 is somewhat of a depressed state because of the
22 difficulties of the forest industries, the transference
23 of workers especially refers to those people being
24 skilled in building. If there is a building boom at
25 a certain place in Sweden, with great scarcity of
26 workers, then 50 or 100 building workers coming from
27 the north will make a very great difference from the
28 point of view of production and the determination of
29 piece rates.

30 This policy of mobility, I think, really helps



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1 us in keeping a higher target for employment than
2 otherwise would be the case. So I put my answer to the
3 question in this way -- but it cannot be given a
4 quantitative precision from this point of view as my
5 answer is relating to the mobility of labour. We think
6 that one per cent unemployment is what we should aim
7 at and try to keep. We are aware of the fact that
8 such a high ambition often mean a too rapid wage
9 increase. We have, at that employment level, with current
10 degree of mobility, admitted that we can stand a
11 general price increase of one to two per cent a year.
12 That is an improvement in price stabilization to what
13 we had before.

14 COMMISSIONER GIBSON: You regard that as a
15 tolerable level?

16 PROFESSOR LUNDBERG: Yes, I regard that as
17 a tolerable level. We think it is bad in a way, but
18 it has to be related to the badness of having more
19 unemployment, and this degree of devaluation of the
20 value of money is not supposed to be too bad. We have
21 higher rates of interest than earlier, when we kept a
22 3 or $3\frac{1}{2}$ per cent long-term rate of interest. At a rate
23 of increase of prices of 4 per cent, people having
24 insurance policies and deposits at the bank had during
25 those years a negative rate of interest. But now
26 we have 5 or $5\frac{1}{2}$ per cent on long term bonds, and having
27 an increase of one or two per cent in the price level
28 in the longer run. It is a tremendous improvement, if
29 you look at the real yield for people saving money.
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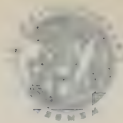


1 COMMISSIONER GIBSON: Is there an increased
2 disposition to save when it is fixed so high?

3 PROFESSOR LUNDBERG: Yes, we think so. We
4 have a rather high marginal propensity to save.

5 THE CHAIRMAN: In spite of an inflationary
6 trend it does not make any difference, or does it
7 affect the interest rate on the long-term securities?

8 PROFESSOR LUNDBERG: Yes, from the policy
9 point of view it can be said that we have adjusted our
10 rate of interest level to the fact that we expect a
11 decline in the value of money in the long run. Very
12 few people do really suffer from this. That is the
13 problem, that you cannot get a pressure interest group
14 saying, "We are the real sufferers because of this
15 deterioration of the value of money," since wage earners
16 are only very partly sufferers when they have money in
17 the bank and in insurance policies. They may gain more
18 by the rapid increase in wages. Nearly everybody is
19 divided, more or less, between having some savings on
20 the one hand and, on the other hand, current wage
21 incomes. We have tried to estimate who suffers from
22 inflations, and there is no clearly defined large group
23 that carries the burden. Even the pensioners are
24 to a considerable extent nowadays guarded against
25 the deterioration of the value of money. It is
26 the danger that few have any strong reason to put up
27 resistance against the deterioration of the value of
28 money. The really strong reason is that we might
29 not survive in international competition and therefore
30 get into balance of payment problems in the long run.



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1 That is the clear reason for resistance for the
2 government, and the employers and trade unions understand
3 that too. If we go too far and have too rapid an
4 increase in price and wage levels we will come into
5 difficulty in the balance of payments. On the other
6 hand during the last years Germany, Holland and some other
7 countries are nowadays "better" than we are at
8 devaluing money.

9 THE CHAIRMAN: Before we get on to some other
10 aspect of this, when you fix a percentage of, say,
11 4 per cent or $1\frac{1}{2}$ per cent or 2 per cent, or whatever it
12 may be, as to unemployment, in order to obtain a clear
13 and accurate idea of what that means we have to know
14 something about the statistical base for that. That
15 is, when is a person statistically unemployed, and for
16 how long is he unemployed, and so on? If you compare
17 the 4 per cent in Sweden with 4 per cent in Canada it
18 may be that the statistical base in the two countries
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1 PROFESSOR LUNDBERG: This is a very important
2 aspect of this problem, of course, the measurement of
3 unemployment is a very difficult problem, and a
4 definition of what is "unemployment" is not easy.
5 Previously we referred our unemployment rates to the
6 rates of the insured workers, but nowadays we have also
7 labour force investigations along the American methods.
8 We do that twice a year, and have definitions very
9 close to the American ones, and I presume it is almost
10 the same as in Canada. According to the last labour
11 force investigations relating to the whole labour
12 force, we had in May of this year 1.2 per cent
13 unemployment, and we had .8 per cent unemployment
14 according to the insurance measurement. So, there is
15 a difference. I don't think when I speak of one per
16 cent, 2 per cent or 4 per cent that there is a
17 significant difference in the concepts of measuring
18 from yours.

19 COMMISSIONER GIBSON: On the question of
20 what is a tolerable price increase, do you believe that
21 Swedish people will think prices will, in fact, rise
22 one per cent or two per cent per annum in their
23 anticipations of the future, or will they be impressed
24 by what has actually happened over the last 15 years or
25 so? To put the question another way, if there is
26 an expectation that prices will rise one per cent or
27 two per cent per annum, will it be possible to keep
28 the rise to as little as that?

29 PROFESSOR LUNDBERG: This is, of course, a
30 problem that is very important and has been discussed



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COMMISSIONER GIBSON: On the question of what is a tolerable price increase, do you believe that Swedish people will think prices will, in fact, rise one per cent or two per cent per annum in their anticipations of the future, or will they be interested by what has actually happened over the last 15 years or so? To put the question another way, if there is an expectation that prices will rise one per cent or two per cent per annum, will it be possible to keep the rise to as little as that?

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1 quite a lot, and many economists have tried to prove that
2 if you have a rise in prices of 3 per cent or 4 per cent,
3 and people expect it will continue, you will have an
4 acceleration. But, that is not our experience. We
5 in Sweden have had a 15-year period with an average of a
6 4 per cent rise per year, and nobody has anticipated that
7 there will be a recovery of the value of money, but
8 expecting this decline to continue. There is, of course,
9 no quantitative precision in the expectations but, anyhow,
10 the whole likelihood is on the side of further price
11 rises in the future. The Swedish monetary policy will
12 never be able to prevent a price rise during booms and
13 in the recessions the price rise will only be slower.
14 Every intelligent person in Sweden has been anticipating
15 a continuing inflation of that nature.

16 Responsible people in government and business,
17 the leaders of trade unions, all those people who are
18 quite aware of the facts reading economic literature
19 to a higher extent than in most other countries and do
20 not forget to speak and write about this. From this
21 point of view it is an interesting fact, that although
22 we have had these anticipations, the price rise has
23 not accelerated; rather it has decelerated. We have
24 come down from 4 per cent to 2 per cent although we are
25 just now up again around 4 per cent. This is not,
26 as I said, thanks so much to policy as to the international
27 surroundings.

28 People in order to avoid losses from and make
29 gains on inflation of course, buy fixed capital: they
30 invest in houses, if they can, and in stocks to a certain



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1 extent, and are apt to borrow money and place the money
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3 happened on such a scale that control has been lost.

4 So, we have no experience of this danger of acceleration
5 from this kind of anticipation.

6 COMMISSIONER GIBSON: Is there a long-term
7 tendency in Sweden away from fixed interest obligations?
8 Is there a decreasing interest in government securities
9 and corporate bonds and a greater interest in equities
10 and that sort of thing? In other words, do people show
11 they expect prices to go on increasing in the future in
12 their actions in the form of their savings?

13 PROFESSOR LUNDBERG: There is no quite clear
14 evidence here, because if you take people's willingness to
15 sign insurance policies, there has been no decline here.

16 COMMISSIONER GIBSON: That is true here also.

17 PROFESSOR LUNDBERG: However there is a clear
18 tendency for people to take more risk insurance policies
19 and less of the savings type. But, on the other hand,
20 the funds of the insurance companies have been increasing
21 very rapidly, as rapidly in real terms as before. Now
22 there is a change, which we might discuss later on,
23 referring to the pension funds coming in, but, except for
24 that, we have not noticed any decline in this type of
25 savings in insurance or in the form of savings deposits.
26 People do have strong habits. On the other hand, there
27 has been an increasing interest in buying homes and
28 investing in equities and stocks. So that, the yields of
29 stocks, especially shares in the wood industries, went
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1 time, because people consider that forests contain real
2 values more than most other things with a guarantee for
3 the value of money, but now the yields are back to 3 or
4 4 per cent again. But this holding of shares and stocks
5 is much less spread in Sweden than in Canada and the
6 United States. As to buying houses and real property,
7 the values of houses available have been increasing
8 sharply because of the excess demand for houses.

9 There is a willingness of people to put themselves into
10 debt and try to gain on real property. But, these
11 tendencies have limited importance: the housing
12 business part of the Swedish economy is very regulated,
13 so the repercussion on the general economy has not been
14 too serious.

15 There have thus been tendencies of this kind
16 discussed, but we hope in regard to the 60's the prospects
17 of inflation will be much less. People really don't
18 expect that 4 per cent will continue as an average, and
19 one per cent to two per cent we consider not bad from
20 the point of view of carrying on a policy with other
21 aims as given.

22 You have here on this continent consoling
23 investigations as to the measuring of a rise in cost of
24 living. One or two per cent increase in the cost of
25 living might be no increase at all because of the
26 improvement of the quality of the goods you present to
27 the consumers. Of course, we never know, but what I
28 would say is only that the prospects of inflation have
29 really been pulled down quite a lot and we are happy with
30 it. However, as already said we hardly dream of coming



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1 down to zero rise of price level. We know that during
2 the booms there will be a more rapid rise in prices, and
3 during the recessions wages will never fall. There may
4 be a downward pressure from abroad on import and export
5 prices, but the general price level will not decline.
6 This is our prospects and we take it with great calm.

7 COMMISSIONER LEMAN: I just wanted to ask
8 Professor Lundberg if all countries can expect this
9 pressure to come from abroad? In other words, if one
10 country expects disciplines to be imported from abroad,
11 the other country expects the discipline to come from
12 abroad too, and that there will be no discipline anywhere?

13 PROFESSOR LUNDBERG: That is correct. Sweden
14 is a small country with big neighbours, and as we have
15 seen it there is, as you know, on the export markets
16 usually heavier competition generally than on the more
17 protected internal markets of the various countries.
18 In the wood products, iron ore and steel products and
19 so on, entrepreneurs are now aware that over-capacity
20 and problems of selling are predominant problems.
21 There will be boom periods when it will be easier to sell,
22 but the need of keeping costs down and having to compete
23 with efficient producers on the Continent and in America
24 is the image our exporters have before them, and that
25 also has an influence on other parts of the economy.

26 This kind of anticipation might be wrong.
27 Most countries carry on an inflationary policy and the
28 pressure downwards in prices may not materialize. But
29 we think the type of development that we have in
30 Sweden is rather general. We don't expect much of



the boom there will be a more rapid rise in prices, and during the recessions wages will never fall. There may be a downward pressure from abroad on import and export prices, but the general price level will not decline. This is our prospects and we take it with great calm.

COMMISSIONER LEWIS: I just wanted to ask

Professor Lundberg if all countries can expect this pressure to come from abroad? In other words, if one country expects disciplines to be imported from abroad, the other country expects the discipline to come from abroad too, and that there will be no discipline anywhere.

PROFESSOR LUNDBERG: That is correct. Sweden is a small country with big neighbors, and as we have seen it there is, as you know, on the export markets usually heavier competition generally than on the more protected internal markets of the various countries. In the wood products, iron ore and steel products and so on, entrepreneurs are now aware that over-capacity and problems of selling are predominant problems. There will be boom periods when it will be easier to sell but the need of keeping costs down and having to compete with efficient producers on the Continent and in America is the image our exporters have before them, and that also has an influence on other parts of the economy. This kind of anticipation might be wrong. Most countries carry on an inflationary policy and the pressure downwards in prices may not materialize. But we think the type of development that we have in Sweden is rather general. We don't expect much of



1 general price increases on products coming from the
2 United States and Canada. As to some continental
3 countries, like Germany, the wage pressure has been
4 higher than before, but production capacity has been
5 increasing too rapidly. The surplus capacity that has
6 developed means that these countries on our own Swedish
7 market are selling and will be selling below their
8 internal prices. They have often high protection and
9 Sweden is a small market and we have low tariffs. Steel
10 and other products come in to Sweden very cheaply, and
11 as consumers we enjoy that. That is, however, a
12 pressure that tells in quite clear language to the trade
13 union leaders and entrepreneurs as well as to the
14 government authorities about the dangers of too much
15 wage inflation at home. I think people really consider
16 this as fact.

17 COMMISSIONER BROWN: You mentioned that
18 interest rates have increased so they are now about
19 5 per cent or 6 per cent. Have corporation profits
20 been showing an increasing trend too to offset the
21 increasing price levels?

22 PROFESSOR LUNDBERG: Yes. Profits have
23 been increasing more or less parallel with the
24 general sales volume of the entrepreneurs. Our profit
25 measures are however not so good as yours or those of
26 the United States, and as a statistician I am sorry for
27 that. But as an entrepreneur I would be happy because
28 the relatively free writing off system we use in
29 Sweden is very good for corporations for concealing
30 their profits. However, for making statistics it is



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Nethercut & Young

Toronto, Ontario

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1 a sad state of affairs. So, really we don't know too
2 much about the actual profit development. If you look
3 at gross profits in industrial companies, that is to
4 say, profits including taxes and depreciations and all
5 that, what you get when you deduct from sales all the
6 current costs for raw material and wages, these gross
7 profits have more or less kept a constant relationship
8 over the last ten years to the production values. That
9 means that productivity has been increasing and that
10 industry has been shifting from less profitable to more
11 profitable branches of activities over time. Now,
12 there are discussions that this development will not
13 hold in the future, as a consequence of the sharp
14 competition on many markets that I spoke about before,
15 the gross profit margins are tending to be reduced.
16 That will mean that the corporations for their
17 investments will not be self-financing to the extent
18 they have been during the 50's.

19 This problem of profits should be mentioned
20 also with regard to wage policies. The trade union
21 economists make very skillful calculations about
22 profitability in different branches of industry, and
23 when profits tend to rise the unions are very eager
24 and quick in demanding wage increases. So that, wages
25 and profits follow each other quite well, just because
26 of the watch kept by the wage earners on the development
27 of profits.

28 COMMISSIONER BROWN: Are they prepared to
29 go down as well as up?
30

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COMMISSIONER BROWN: Are they prepared to go down as well as up?



1
2 PROFESSOR LUNDBERG: No, never down, no.

3 COMMISSIONER GIBSON: If there are no other
4 questions on the objectives of monetary and economic
5 policy, I would like to ask Professor Lundberg a few
6 questions about the nature of Swedish monetary policy.

7 In your recent writings, particularly in
8 the Skandinaviska Banken Quarterly Review you have
9 drawn a contrast between what you describe as the
10 Swedish line of monetary policy and the American line.
11 If I might quote you very briefly, you said, speaking
12 of the Swedish line:

13 "By means of one form, the policy
14 may aim at creating -- through a system of
15 liquidity and investment quotas, possibly
16 including a ceiling on loans -- a number of
17 obstacles to credit transfers and, in this
18 way indirectly also holding back the rise
19 in the velocity of circulation that would
20 otherwise threaten to restrict or eliminate
21 the dampening effect of a relative contraction
22 in the supply of money. Controls, rationing
23 and priorities for the controllable sectors
24 of the credit market -- such measures belong
25 to this type of policy which, for simplicity,
26 we shall call the 'Swedish line'.

27 The alternative form, which I call the
28 'American line', aims at avoiding public
29 control of the credit market as an instrument
30 of economic policy, instead allowing a



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1 contraction of the supply of money to
2 have free play in the whole of the credit
3 system via the functionings of the capital
4 and credit markets.

5 The difference as compared with
6 the Swedish line lies in the absence
7 of attempts to utilize, as active
8 weapons in the monetary policy armoury,
9 measures that are designed to put the
10 credit market partially out of
11 function -- to make it operate
12 especially badly during periods of
13 inflationary expansion."

14 This is a very interesting statement, and
15 I wonder in the light of that if you would care to tell
16 us a little about the recent Swedish stabilization
17 measures in the monetary sphere?

18 PROFESSOR LUNDBERG: I think we are a little
19 on the way to trying to avoid too much of the type of
20 rationing and credit ceiling policies and putting
21 obstacles to the functioning of credit markets as we
22 did during the boom up to 1957. There is a tendency
23 to create a little more of a better functioning of
24 capital and credit market -- not much, from an American
25 point of view -- but I think there is a growing
26 awareness among the authorities that in the long run it
27 may be difficult to use this "Swedish" kind of
28 interference policy.



Statement of the Committee on Finance

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PROFESSOR LUNDBERG: I think we are a little on the way to trying to avoid too much of the type of rationing and credit ceiling policies and putting obstacles to the functioning of credit markets as we did during the boom up to 1937. There is a tendency to create a little more of a better functioning of capital and credit market -- not much, from an American point of view -- but I think there is a growing awareness among the authorities that in the long run it may be difficult to use this "Swedish" kind of interference policy.



1 On the other hand, the Swedish authorities
2 have no great respect for the free functioning of the
3 credit of capital markets as giving some kind of optional
4 allocation of resources out of itself. You will find
5 much more of that view in the United States. The
6 functioning of the capital and credit markets, just
7 as a market in our text books, is supposed to allocate
8 the resources in such a way that you get some kind of
9 an optimum distribution of the savings funds available
10 to the economy.

11 In Sweden there are views as to priorities
12 for using savings that the Swedish authorities think
13 are not automatically taken care of by the market
14 mechanisms. There are certain government expenditures
15 of an investment nature that have high priority -- for
16 building up the interest structure of the economy and
17 they are, of course, allocated by fiscal means. That
18 method is used in all countries. Secondly, and this
19 is the most disturbing part of the policy, is our
20 housing problem; this is perhaps the blackest part of
21 Swedish economic policy. You know, the German
22 people speak about "Wirtschaftswunder", which means
23 the wonder that has happened in Germany with rapid
24 economic development. We in Sweden have also a
25 "Wirtschaftswunder", namely that we have had a record
26 building of houses since the end of the war, we have
27 had no destruction of houses because of the war and
28 we have the lowest increase of rate population in
29 the world, nearly, and yet we have one of the highest
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On the other hand, the Swedish authorities have no great respect for the free functioning of the credit or capital markets as giving some kind of optional allocation of resources out of itself. You will find much more of that view in the United States. The functioning of the capital and credit markets, just as a market in our text books, is supposed to allocate the resources in such a way that you get some kind of an optimum distribution of the savings funds available to the economy.

In Sweden there are always as to priorities for using savings that the Swedish authorities think are not automatically taken care of by the market mechanism. There are certain Government expenditures of an investment nature that have high priority -- for building up the investment structure of the economy and they are, of course, allocated by fiscal means. That method is used in all countries. Secondly, and this is the most disturbing part of the policy, is one housing problem; this is perhaps the blackest part of people speak about "Wirtschaftswunder", which means the wonder that has happened in Germany with rapid economic development. We in Sweden have also a "Wirtschaftswunder", namely that we have had a record building of houses since the end of the war, we have had no destruction of houses because of the war and we have the lowest increase of rate population in the world, nearly, and yet we have one of the highest degrees of shortage of housing, of excess demand for



1 housing in most of the civilized world. This is a very
2 disturbing factor to the policy measures because the
3 government has to, or likes to, allocate a very large
4 part of the gross savings for financing house building
5 and therefore also must prevent a squeeze of the
6 monetary policy from having bad effects on house
7 building. In order to protect the financing of house
8 building devices must be introduced and one such measure
9 is liquidity quotas.

10 The banks have to keep, during monetary
11 squeezes, a certain proportion of their assets in
12 government bonds and in bonds financing house credits.
13 (There are special institutions for that). The current
14 credit for house building is also usually kept outside
15 the policy measures. This means that a priority for
16 house financing must be disturbing from the point of
17 view of an "American" type of monetary policy
18 preventing the free play of market forces on the credit
19 markets. This is one of the backgrounds explaining
20 the interference with the credit markets in Sweden.

21 COMMISSIONER GIBSON: You make a further
22 point which is that under the American system, as
23 you described, when money is tight and the demand
24 for credit very strong, the rise in interest rates
25 that occurs tends to increase the velocity of money
26 or result in secondary credit creation, and this is
27 very hard to control. You point out that the
28 system of interfering with the transfers of credit,
29 which you describe as typical of the Swedish line,
30 does in fact slow down the velocity in the secondary



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1 creation of credit, and this is a fundamental point
2 in your mind, I take it?

3 PROFESSOR LUNDBERG: Yes, that is the
4 second point I am coming to now. The first point
5 was the background for that kind of priority measures
6 which were to secure the priority in getting savings
7 for certain investment purposes. If you take
8 government and housing expenditures and community
9 expenditures, that is about half of the total gross
10 investments in the economy. This position is
11 excluded from the free play of the markets.

12 When we come to policies during a boom,
13 to carry out a restrictive monetary policy, there are
14 efforts in Sweden to work on, as you say, interfering
15 with the credit system. In the past we have tried
16 to put ceilings on bank advances, the total credit to
17 industry and trade given by the commercial banks.
18 This is one such type of interference of a very direct
19 nature creating credit rationing.

20 Then, we have the type of liquidity ratios
21 that I spoke about before. The Swedish concept
22 is different from yours and from the American as
23 also applying to the other banks or institutes at the
24 side of the commercial banks.

25 There is a law concerning the putting into
26 force of liquidity ratios that is potentially there.
27 It had been used in 1950 - 1952, but potentially it can
28 be put into force at any time when it is considered
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1 "quite willing" to make agreements rather than have
2 the law put into force. The law might be more rigid
3 and more dangerous to apply to the banks than having
4 discussions and agreements on a freer basis with the
5 central bank. The liquidity ratio given as a
6 maximum, according to the new law, is 50 per cent,
7 meaning that the commercial banks should keep in
8 relation to the total deposits, government securities
9 and treasury bills, as well as the housing corporation
10 bonds up to this size. This means that if there is
11 an increase in the prescribed liquidity ratio during
12 a boom period there will be a squeeze on advances,
13 loans to the private sector of the economy. There
14 is also a law that gives possibilities of regulating,
15 of putting maximum and minimum rates of interest on
16 banks and the other savings institutions. During
17 a squeeze of the banks when competing with each other,
18 they may try to get more deposits from the public
19 by raising rates of interest. The authorities
20 can stop such tendencies by putting maximum on the
21 rates of interest. Such a policy means that credit
22 rationing will be the result. This law of
23 regulating maximum and minimum rates of interest has
24 never been applied. It gives also a background
25 for making "voluntary agreements" with the banks of
26 not competing with each other by raising interest
27 rates too much.

28 THE CHAIRMAN: You wouldn't
29 have arrived at this agreement unless the law were
30 there?



1 THE CHAIRMAN: Now we will
2 have arrived at this agreement unless the law were
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1 PROFESSOR LUNDBERG: We don't know.

2 I mean, they could always suspect such a law might be
3 created anyhow, and Sweden is a small country and
4 it is not too difficult to make an agreement with
5 a handful of men about such policies. These people
6 are reasonable even if the central bank is unreasonable
7 in their demands on the commercial banks. All this
8 means -- and that was my point in the article that
9 you quoted, sir -- that the monetary policy in
10 Sweden is to a very high extent relying on credit
11 rationing policies by the institutions. The law
12 for regulating rates of interest includes rules for
13 controlling the issue of bonds and similar loan
14 instruments. No industrial corporation can issue
15 bonds without the allowance of the central bank with
16 control of the conditions of issue.

17 All this means is that credit rationing will
18 be an important instrument of policy in a monetary
19 squeeze. Coming back to what you referred to as the
20 velocity of circulation, such a squeeze will mean
21 that corporations having deposits in the banks, when
22 they don't get new advances or loans, and when their
23 customers don't get it, that they will use these
24 deposits at a higher speed than usually is the case.
25 There is no possibility of preventing these grey markets
26 -- we don't call them black because they are not very
27 black. This increase of velocity of circulation
28 of banking deposits is a factor counteracting
29 monetary restriction. I think this effect is very
30 important and quite good for the Swedish economy,



I mean, they could always suspect such a law might be created anyhow, and Sweden is a small country and it is not too difficult to make an agreement with a handful of men about such policies. These people are responsible even if the central bank is irresponsible in their demands on the commercial banks. All this means -- and that was my point in the article that you quoted, sir -- that the monetary policy in Sweden is to a very high extent relying on credit rationing policies by the institutions. The law for regulating rates of interest includes rules for controlling the issue of bonds and similar loans instruments. No industrial corporation can issue bonds without the allowance of the central bank with control of the conditions of issue. All this means is that credit rationing will be an important instrument of policy in a monetary squeeze. Coming back to what you referred to as the velocity of circulation, such a squeeze will mean that corporations having deposits in the banks, when they don't get new advances or loans, and when their customers don't get it, that they will use these deposits at a higher speed than usually is the case. There is no possibility of preventing these grey markets -- we don't call them black because they are not very black. This increase of velocity of circulation of banking deposits is a factor counteracting monetary restriction. I think this effect is very important and quite good for the Swedish economy.



1 because if you just stop the functioning of the credit
2 market by putting sticks into the wheels, it will
3 break down. Now, we have this secondary mechanism
4 of using deposits and that means making the whole
5 process smoother. Of course, there will be
6 fluctuations and a dampening effect, as we have seen
7 it, because the contracts between the different credit
8 markets is not too close.

9 In our experience, especially referring to
10 the smaller firms and smaller corporations, not
11 having been able to accumulate large deposits, are
12 coming into a squeeze especially severely. It is
13 always the minority. That is always the difficulty
14 with this world; in your common contacts with most
15 people they will say that this kind of monetary policy
16 does not work. They are not affected. I have
17 met many industrial people from big corporations during
18 our periods of monetary restrictions and they say they
19 are not disturbed at all. And, of course, we mostly
20 meet people who are not disturbed. We don't see
21 so much of the minority who are disturbed because
22 they are not frequent. According to the interviews carried
23 out in Sweden -- and I refer to this in my memo --
24 it was just some quarter of the corporations,
25 especially the smaller ones, which came into
26 difficulties and had to cut down on investment
27 programmes. That was quite sufficient to dampen
28 the boom.

29 My point is that this is bad policy from
30 many points of view. If we have a very rapid



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My point is that this is bad policy from
many points of view. If we have a very narrow



1 repetition of booms and we have to use these interference
2 instruments very frequently, it means in the longer run
3 bad allocation of saving resources.

4 COMMISSIONER GIBSON: I was going to
5 ask you about the allocation of resources and the
6 question of equity in this kind of policy.

7 PROFESSOR LUNDBERG: I don't know if I
8 have answered your question correctly, Mr. Gibson.

9 COMMISSIONER GIBSON: Well, what about
10 the question of allocation of resources and the
11 question of equity in this kind of a policy?

12 PROFESSOR LUNDBERG: You know, the
13 Swedish government, as most governments, has no sense
14 of scientific responsibility! They do too many
15 things at the same time, so we can't find out the
16 efficiency of the various policy instruments. We
17 would like the government to have more sense of
18 scientific isolation, of doing one thing at one time
19 so that we could really find out how the policies
20 work.

21 When we applied these stringent measures
22 during the period up to 1957, and again in another
23 form during the boom of 1960 and 1961, other measures
24 were used very much too; we have had the investment
25 tax and we have had the investment fund methods,
26 and doing a lot of other things too, so we can't
27 clearly read off the effect of each instrument.



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and doing a lot of other things too, so we can't

clearly read off the effect of each instrument.



1 COMMISSIONER GIBSON: You are, in fact,
2 making a lot of deliberate decisions that involve
3 the allocation of resources but not being too clear
4 on what the end result is, I take it, is that
5 fair?

6 PROFESSOR LUNDBERG: Yes, that is fair.
7 You know, the primary aim is to dampen a boom that
8 is developing. We notice a boom coming first
9 usually in the investment field and the export field,
10 and that can be seen a bit in advance. We make
11 inquiries two or three times a year about investment
12 plans, and even if the investment plans in industry
13 and other fields are a little uncertain, they are
14 indicating other tendencies of the development. When
15 it is clear that an investment boom is developing, then
16 the government tries to dampen it and when they dampen
17 it, of course, they can't be sure that those
18 investments which are eliminated or reduced are the
19 least efficient, and less useful from a productivity
20 point of view for the whole of the economy than those
21 investments that are unaffected. Those corporations,
22 whose investments are reduced have perhaps accidentally,
23 too small deposits in the banks or haven't ultimate
24 connections with the banks or haven't promises
25 as to credit limits. But, who knows if these
26 corporations have the least productive investment
27 projects. Maybe the corporations in question have
28 very efficient investment projects. But nobody
29 can prove that, of course. I have made an
30



MISSISSAUGA GINSON: You are, in fact

making a lot of deliberate decisions that involve the allocation of resources but not being too clear on what the end result is, I take it, is that fair?

You know, the primary aim is to dampen a boom that is developing. We notice a boom coming first

usually in the investment field and the export field,

and then can be seen a bit in advance. We make

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1 investment study for a book published recently on
2 the profitability of investment in the Swedish
3 economy and tried by interviews of 200 corporations,
4 to find out what were and are, during a certain time,
5 the differences of the yield of various kinds of
6 investments. That was during the time when credit
7 squeezes were applied, and I was taken aback by the
8 fact of how widely varying the yields were that there
9 was a tremendous scale of difference between the
10 projects, and to a certain extent I think this was
11 the result of credit rationing policies.

12 If we had had a more fluid credit system,
13 if the funds had been more flexible and could go to
14 the investments -- that were most profitable --
15 we would get a better productivity result. I am
16 afraid that there is danger of this sort in applying
17 too much of credit rationing.

18 In every market where there is much of
19 rationing, it can be expected in the long run to result
20 in bad distribution of resources.

21 It is a strange thing that the Swedish
22 economy, when talking about the labour market policy,
23 then there is a very liberal attitude of making
24 labour freely available and create an effectively
25 functioning market. The trade union policy is aiming
26 at reaching about the same price for the same kind
27 of labour all over Sweden.



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1 The other way of having restrictive monetary
2 policy and avoiding rationing would be to have a much
3 higher rate of interest than we have had, as I mention
4 in this memorandum. The investment tax that we used
5 from 1955 to 1957 really means a "total rate of
6 interest" of 12 to 18 per cent during those years.
7 That tax was perhaps a better kind of means of allocating
8 resources in a rational way than corresponding rationing
9 of credit would have been.

10 Nobody can measure how much productivity
11 will be lost by having a bad labour policy or a bad
12 credit policy. I think we would have gained a little
13 more if we had had a better monetary or credit policy.
14 As I see it now, there is hope of doing it better
15 during the 1960's than was the case during the 1950's,
16 and that is partly because we are closer to equilibrium
17 as between demand and supply than we were in the
18 1950's. That is another chapter which we might come
19 back to.

20 THE CHAIRMAN: I think we should adjourn
21 for a few moments at this time.

22 ---A short recess.

23 COMMISSIONER LEMAN: Professor Lundberg, I
24 want to ask you some questions about the effectiveness
25 of monetary policy. Just before the recess I think
26 you had begun to talk about that. You were explaining
27 how you had made some inquiries in relation to this
28 problem in trying to find out how people reacted, and
29 what interest rates did to projects, etc. During
30 the course of those inquiries did you go a little



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Nobody can measure how much productively will be lost by having a bad labor policy or a bad credit policy. I think we would have gained a little more if we had had a better monetary or credit policy. As I see it now, there is hope of doing it better during the 1960's than was the case during the 1950's, and that is partly because we are closer to equilibrium as between demand and supply than we were in the 1950's. That is another chapter which we might come

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want to ask you some questions about the effectiveness of monetary policy. Just before the recess I think you had begun to talk about that. You were explaining how you had made some inquiries in relation to this problem in trying to find out how people reacted, and what interest rates did to projects, etc. During the course of those inquiries did you go a little



1 further and also try to get some quantitative measures
2 of what we call the problem of lags in reaction, and
3 the effectiveness of policy measures before they work
4 through the system? That is a related subject. Would
5 you tell us what you have discovered in this field?

6 PROFESSOR LUNDBERG: I think we are discussing
7 two problems here, and also two inquiries or invest-
8 igations. The one I referred to in my last speech was
9 an interview study as to the kind of profitability
10 rates, or rates of internal yield, that corporations
11 demanded on the investment funds used during a certain
12 period of time, and that had to do with a question of
13 Mr. Gibson about the allocation of savings resources.
14 What you are referring to now is the problem of the
15 efficiency of monetary policy. What I spoke about was
16 the inefficiency of monetary policy from the point of
17 view that it created a disparity of yields that might
18 have had effects on the allocation of resources. You
19 are referring now specifically to how effective the
20 monetary policy is under certain circumstances in
21 breaking a boom, and what lags we experienced.

22 Then I have referred to another inquiry
23 mentioned in my memorandum that was done in 1955-56,
24 and that one dealt with the effects on investment of the
25 credit rationing and the investment tax, and the rise
26 in interest rates during 1955 and 1956.

27 The results show that although we had a very
28 rapidly development investment boom from the fall of 1954
29 the measures taken, beginning with the investment tax
30 of 12 per cent and credit rationing with a ceiling on



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6 PROFESSOR LUMBERG: I think we are discussing

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1 advances applied to the commercial banks from the
2 middle of 1955, and also an interest rate increase of
3 one per cent, had the effect of dampening the investment
4 plans of entrepreneurs and corporations within
5 manufactures by about 15 per cent. According to
6 these interview studies, investments became 15 per cent
7 lower in 1955-56 than they had tended to be according to
8 the interviews conducted in the fall of 1954 before
9 these measures were taken.

10 Of course, interview studies are difficult
11 and dangerous, and managers might like to just give
12 personal views without giving much thought to the subject.
13 But we have some confidence in those interviews conducted
14 in 1955 and 1956 because they were made under relatively
15 good auspices during a time when the managers were really
16 re-considering their investment plans because of these
17 very important changes in conditions that had happened
18 during a short time, and the results fit relatively well
19 into the statistics on investment that were available
20 later on.

21 Accordingly, this resulted, as I have said,
22 in a cutting down of investment by something like
23 15 per cent. That did not mean that investment
24 actually went down by 15 per cent, but investments were
25 lower than they would otherwise have been. That
26 means that the measures taken in 1955 had a quick
27 effect. There was not a long lag.

28 This lag business is a difficult problem,
29 of course. In the United States especially
30 there have been studies made of the lags in monetary



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Of course, interview studies are difficult and dangerous, and managers might like to just give personal views without giving much thought to the subject. But we have some confidence in those interviews conducted in 1955 and 1956 because they were made under relatively good auspices during a time when the managers were really re-considering their investment plans because of these very important changes in conditions that had happened during a short time, and the results fit relatively well into the statistics on investment that were available.

Accordingly, this resulted, as I have said, in a cutting down of investment by something like 15 per cent. That did not mean that investment actually went down by 15 per cent, but investments were lower than they would otherwise have been. That means that the measures taken in 1955 had a quick effect. This lag business is a difficult problem, of course. In the United States especially there have been studies made of the lags in monetary



1 and fiscal policy, and it has usually been found that
2 there are usually quite long lags. Milton Friedman
3 in Chicago is well known for his 16-month lag in
4 monetary policy. However, I think that that kind of
5 analysis is very dangerous because it is taken as a
6 fact that there is something in the structure of the
7 economy that makes entrepreneurs react to changes in
8 economic conditions in a relatively fixed way. My view
9 is, and that is to a certain extent confirmed by this
10 Swedish interview study, that the lags in reaction
11 depend very much upon how big the changes are. For
12 instance, you can make such a drastic change as making
13 all credit unavailable to those having ambitious
14 investment plans so that most of those investments stop
15 immediately. You can make the whole policy result in
16 a catastrophe, and maybe have a lag of just a few seconds
17 after the announcement.

18 Central banks are usually not too sure about
19 economic projects so that they start by increasing the
20 discount rate by a quarter of or half of one per cent.
21 In such a case you might have no reaction at all during
22 a long time, or you might even have an inverse reaction,
23 because people might anticipate that this is just the
24 beginning of a more restrictive monetary policy. They
25 may think that a quarter of one per cent is clearly too
26 little, and expect that after a time lag the central
27 bank will discover that it is not enough and that the
28 rate later will be raised more. The result tends to
29 be that investment and borrowing are accelerated.
30 In that case you may thus get an inverse or negative



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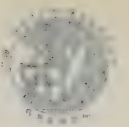


1 lag when the policy creates the wrong kind of
2 anticipation.

3 What was interesting from the point of view
4 of the Swedish experience that I referred to, and what
5 the interview studies show, is that if you make your
6 policy changes drastic enough the anticipation will
7 support the policy. High investment taxes and severe
8 credit rationing cannot last long, so that people who
9 could postpone investments did so rather than pay the
10 investment tax of 12 per cent or get their financing on
11 the grey markets at high cost and great risk. Those
12 entrepreneurs, if at all possible, would rather wait
13 before making investment or they would cut down on their
14 investments in inventories. The latter happened to
15 quite an extent. In order to finance fixed investments
16 some entrepreneurs realized on inventories. When that
17 happens you get good results because that means less
18 pressure on the resources of the economy.

19 My point here is that the concept of lags
20 should be referred to the size of the change in the
21 monetary perimeters in question. My opinion is that
22 if you make a drastic change in a boom such as developed
23 in 1954 and 1955 you get efficient results. If the
24 authorities in Sweden had made only some slight
25 change in the discount rate and in the general monetary
26 policy the boom might even have been stimulated during
27 1955.

28 I think this experience is interesting also
29 from the point of view that you often hear of
30 economists who do not believe in monetary policy



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1 saying that a needed drastic change in interest rates
2 and in other policy measures in the monetary field will
3 create a crisis; that they will create a collapse of
4 investment. That did not happen in Sweden. There was a
5 12 per cent investment tax plus an increase in rates of
6 interest so that the cost of money went up by 13 per cent
7 over the year -- and that was drastic -- but the collapse
8 did not occur. Investments stayed at a stable level.

9 If the Swedish authorities had done these
10 measures in 1957 just at the top of the boom when
11 international market conditions were deteriorating
12 -- if we had been silly enough to introduce these
13 measures after waiting so long -- then a catastrophe
14 might well have occurred. There might under those
15 conditions have happened a drastic cut-down in investment
16 expenditure.

17 Timing is very important when studying lags
18 and studying the effects. I do not know if I have answer-
19 ed your question. Perhaps I have answered only a part
20 of it.

21 COMMISSIONER LEMAN: I would like to refer you
22 to a statement you make at page 16 of your memorandum:

23 "There has been relatively good
24 success with policy measures aiming
25 at counteracting recessionary tendencies.
26 In a way, this has been an easier part
27 of policy that the restriction problem
28 during inflationary booms".

29 PROFESSOR LUNDBERG: Yes.

30 COMMISSIONER LEMAN: Why do you believe that



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2 and in other policy measures in the monetary field will
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6 interest so that the cost of money went up by 12 per cent
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21 COMMISSIONER LEMMAN: I would like to refer you
22 to a statement you made at page 16 of your memorandum:
23 "There has been relatively good
24 success with policy measures during

25 In a way, this has been an earlier part
26 of policy than the monetary problem
27 during inflationary periods.
28 PROFESSOR LINDBERGH: Yes.
29 COMMISSIONER LEMMAN: Why do you believe that



1 was so?

2 PROFESSOR LUNDBERG: Well, that is an
3 evaluation. You know, we succeeded in Sweden in the
4 boom of 1955-57 in stopping the investment boom in
5 industry. That is correct. That was a relative
6 success. We did not succeed at all in preventing prices
7 and wages from rising, and we did not succeed, generally,
8 in preventing an excess demand for labour and for goods
9 during that time. I mean that there was only a relative
10 success. It could have been worse. We were more
11 successful, perhaps, than some other countries, and it
12 was important that we learn a little about the sensitivity
13 of the economy to measures of this nature. But, on the
14 other hands, I think that we were more clearly successful
15 -- this is on the other side, of course -- in getting
16 a counter-balancing effect during the recession of
17 1958-59.

18 I think that the most remarkable feature
19 of the Swedish economic policy experience during the
20 post-war period is that we succeeded in getting an
21 investment boom during the recession. I do not know
22 of any other country that has succeeded in that.

23 Of course, that was partly an effect of
24 pulling down investment during the boom, so the periods
25 should be looked upon combined. You are right in that.
26 I could not just say that this success during the
27 recession was independent of what had been done during the
28 boom. The results are, of course, inter-dependent, but
29 I think that when compared with other countries, and seeing
30 the recessionary forces at work on the Swedish economy,



1 was not?

2 PROFESSOR LUNDBERG: Well, that is an

3 evaluation. You know, we succeeded in Sweden in the

4 boom of 1952-57 in stopping the investment boom in

5 industry. That is correct. That was a relative

6 success. We did not succeed at all in preventing prices

7 and wages from rising, and we did not succeed, generally,

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1 Sweden was remarkably in getting an increase in industrial
2 investment of 15 per cent from 1957 to 1958, and another
3 increase of 15 per cent from 1958 to 1959, just by
4 taking away restrictive measures that had been in force
5 during the boom period of 1955-57, and also using the
6 investment fund technique. That also played a role.

7 COMMISSIONER LEMAN: So that you contrast in
8 your memorandum the measures that were taken in the 1955-57
9 boom with those that were taken in the 1959-61 boom,
10 and the latter ones were of a different character and
11 were much less pervasive in the sense that they
12 implied less interference than was the case with respect
13 to the first ones; am I correct in that?

14 PROFESSOR LUNDBERG: Yes.

15 COMMISSIONER LEMAN: Is that due partly to
16 the fact that you did not like some of the results of
17 the measures taken in the 1955-57 boom, or is it because
18 you then thought that the character of the 1959-61
19 boom was quite different from the first one?



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COMMISSIONER LAMAR: So that you contrast in
your memorandum the measures that were taken in the 1955-57
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were much less pervasive in the sense that they
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COMMISSIONER LAMAR: Is that fair to
the fact that you did not like some of the results of
the measures taken in the 1955-57 boom, or is it because
you then thought that the character of the 1959-61
boom was quite different from the first ones?



PROFESSOR LUNDBERG: I think the second statement of yours is more correct. From the point of view of dampening the boom the measures during the 1955-57 period were relatively successful, but from the point of view of growth and productivity development of the economy in the longer run it was a dangerous policy.

This dampening down of investments in private industry during the boom meant, really, that the volume investments in 1957 were not higher than in the previous boom of 1951. We discussed that heavily in Sweden and I among others criticized the policy. From the growth point of view, in the longer run it was dangerous to keep down investment in private industry for such a long time by means which were effective for dampening a boom but dangerous from the growth point of view.

During the second boom, from 1959, government authorities were aware of the fact that it would be dangerous, again, to let private industry carry the burden. They were aware of the fact that changes in the world market were very impressive and that the Swedish industry had to adjust itself to the coming European market and other changes in the export markets; and we were afraid of getting behind in the rise of productivity in the other countries. It would be better with these perspectives to use the same type of measures and just to clamp down on investments in industry.

I think that speaks well for the authorities,



Statement of J. Edgar Hoover, Director of the Federal Bureau of Investigation

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1 that during the time 1959-61 they were more restrictive
2 as to government expenditure and tried to restrict
3 communal expenditure to a certain extent, so that
4 restrictions on private investment in industry could
5 be very limited. In a way one can only speak of
6 the low effectiveness of monetary policy during this
7 time, because the method of squeezing liquidity out
8 of the commercial banks and putting on the stringent
9 monetary policy, with rising interest rates and a
10 certain amount of rationing, had hardly any visible
11 effect we can now see on private investments during
12 that time, and the boom was not interrupted up to
13 1961. I think that was a "successful failure" if
14 that expression is allowed, and we are not quite clear
15 as to what extent it was intended or was not intended.
16 Anyhow, here you get a good example of what you were
17 asking about in the first question, that there was
18 a long lag between monetary stringencies and an
19 effect on investments.

20 We are happy that investments in private
21 industry were relatively undisturbed, and we developed
22 in the traditional fields and the productivity
23 increased in the Swedish economy generally. But
24 here you have an example of a long lag of squeezing
25 money out of the banks and, again, the effects on the
26 industry. That was in contrast to the drastic
27 measures taken in 1955.

28 This kind of policy was apparently intended,
29 as people were aware that it would be dangerous to
30 deter private investment of industry, of the type and



...the time 1950-61 they were more restrictive

...the government's position was more restrictive

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1 to the degree that it had been done in 1955-57.

2 COMMISSIONER MACKINTOSH: In the earlier
3 period the fault you later saw was that far too
4 drastic a contraction was placed on the private
5 sector while the public housing sector was protected
6 from it; and the difference between the two was
7 largely the difference in approach to those two
8 sectors?

9 PROFESSOR LUNDBERG: Yes. There is the
10 risk that the policy will be too effective. I
11 think the experience in 1955-57 is very interesting,
12 but it was disturbing in a sense. We dampened the
13 boom, but it was on the cost of long-term productivity,
14 and we could not risk to have that type of dampening
15 again. There are always interactions between the
16 short and long term, of course, in this respect. From
17 the point of view of government expenditure the infra-
18 structure of the economy had been increasing rapidly
19 in relation to other fields during a long period.
20 Then the government was more able to cut down and
21 limit expenditures in those fields. That was one
22 aspect of it. At the same time they were aware
23 that because of development in the international
24 field Swedish industry should not be too disturbed
25 by a repetition of the measures taken in the 1955
26 to 1957 period.

27 Also, I should add -- and that is an
28 important aspect that I forgot to mention before --
29 that the difference from the previous boom period
30 was also that in the period 1960 to 1961 the government



sector while the public housing sector was protected from it; and the difference between the two was largely the difference in approach to those two

PROFESSOR LUNDBERG: Yes. There is the risk that the policy will be too effective. I think the experience in 1955-57 is very interesting, but it was disturbing in a sense. We damaged the boom, but it was on the cost of long-term productivity, and we could not risk to have that type of dampening again. There are always interventions between the short and long term, of course, in this respect. From the point of view of government expenditure the infrastructure of the economy had been increasing rapidly in relation to other fields during a long period. Then the government was more able to cut down and limit expenditures in those fields. That was one aspect of it. At the same time they were aware that because of development in the international field Swedish industry should not be too disturbed by a repetition of the measures taken in the 1955 to 1957 period.

Also, I should not -- and then it is an important aspect that I forgot to mention before -- that the difference from the previous boom period was also that in the period 1960 to 1961 the government



1 aimed at dampening consumption expenditure by
2 introducing an expenditure tax of a little over 4
3 per cent. That was, of course, a great difference
4 from the previous period. The policy was to have
5 the private investment sector more undisturbed and
6 have more of the anti-inflationary policy directed
7 towards private consumption and government expenditure.

8 COMMISSIONER MACKINTOSH: Did this result,
9 to any degree, from a view that the later boom had
10 a somewhat different pattern from the earlier
11 boom; that consumption expenditures were a bigger
12 factor in the later boom; or was it just that
13 you wanted to spread the pressure over more of the
14 economy?

15 PROFESSOR LUNDBERG: I think the second
16 statement is correct, that we wanted to spread
17 the pressure over more of the economy.

18 THE CHAIRMAN: During the 1957 to 1959
19 period when, you said, you got an investment boom
20 during the recession, at that time was the demand
21 for Swedish exports strong?

22 PROFESSOR LUNDBERG: It was weaker than
23 it had been during the boom, but the export volume,
24 I think, fell by one one per cent, or something like
25 that, during 1958, and started recovering in the
26 middle of 1959 very rapidly. In the long term view
27 the export picture was very optimistic.

28 THE CHAIRMAN: That would have had quite
29 an effect on improving the situation?

30 PROFESSOR LUNDBERG: Yes.



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THE CHAIRMAN: How would you have had quite
an effect on improving the situation?



1 THE CHAIRMAN: I am wondering to what
2 extent it was due to the monetary policy applied,
3 or to what extent it was due to a steady demand which
4 had the prospect of improving?

5 PROFESSOR LUNDBERG: I think it is both.

6 THE CHAIRMAN: I suppose it would be,
7 yes.

8 PROFESSOR LUNDBERG: I presume the policy
9 with regard to investment funds will be discussed
10 later. But this part of policy of making
11 entrepreneurs invest during a recession and having
12 them postpone investment from a boom period to a
13 recession period could only occur if they were
14 optimistic about the future. Management have been
15 expecting increased demand for export products, and
16 in the home market in Sweden. They must be
17 confident in future expansion prospects otherwise
18 we would not get this type of reaction. The method
19 is just to postpone the will to invest from the boom
20 to the recession period and therefore counteract it.
21 The recessionary forces in Sweden have referred
22 primarily to the exports and to inventories. In
23 foreign countries there are heavy fluctuations in
24 inventories of Swedish export products. When there
25 is an inventory recession and not a general decline
26 in demand you can preserve long term optimism. In
27 fact, during the recession people were glad
28 government policy had helped them to invest during
29 a recessionary time, when the availability of steel,
30 cement and other products means that their investment



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Government policy had helped them to invest during

a recessionary time when the availability of steel,

cement and other products means that their investment



costs were lower than if they had made their investment during the previous boom. This kind of help was, in a way, appreciated. But it depends very much on optimism in future development.

COMMISSIONER MACKINTOSH: This was a matter of taking out postponed investments in a situation in which you had a very strong growth trend.

PROFESSOR LUNDBERG: We have not had a very strong growth trend in Sweden, but a moderate growth trend. Of course, that depends on what you relate it to. There were expectations and confidence exhibited of expanding markets and full employment, and there was a drive on mechanization and cutting down costs; and that sort of investment was necessary because wages were rising rapidly.

COMMISSIONER MACKINTOSH: "Moderate" is a relative word. A moderate growth trend would look very strong to us in the last few years.

COMMISSIONER LEMAN: I am trying to understand a little more precisely why you lack confidence in the more traditional approach of squeezing through the bank system. Is it because you do not think you can have a significant enough rise in the cost of money, or because you find people get around the barriers you put up. Do people learn to get around the obstacles you put up? Is that partly the reason why you get more lags and lack of effectiveness?

PROFESSOR LUNDBERG: This, again, depends on



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PROFESSOR LUNDBERG: This, again, depends on



1 how drastic you are as to policy. When we had the
2 credit rationing measures in 1955-56 we got, according
3 to the interviews, half of the total effect of
4 dampening down investment from this policy instrument.
5 Investment tax took over the other half. So credit-
6 rationing policies, with ceilings and liquidity
7 arrangements, and all that, had an effect which
8 was quite large during that period. That is an
9 example of possible effectiveness when using the
10 measures drastically. But in the 1960-61 period,
11 when the measures taken were not so drastic, the time
12 lags were long and the effects were hardly visible.
13 We carried out no interviews to study the effect,
14 but perhaps if you had interviewed at that time
15 investment might have been still larger than
16 actually came out. But we know too little about
17 that period.

18 Also I should mention -- and I think I
19 do say in my memo -- that conditions during the
20 fifties were more difficult to manage by monetary
21 policy means than we think they will be during the
22 sixties, as we look at the sixties now. The
23 inflationary anticipations were very strong in 1954
24 to 1957, when people were just geared toward
25 the anticipation of rapid inflation and profit
26 prospects were high and markets were booming. Then,
27 people did not care so much for the cost of investment.
28 It is very difficult to manage and prevent high
29 booms by policy measures, and we have then to use
30 quite drastic means. But as we look at the



how drastic you are as to policy. When we had the credit rationing measures in 1955-56 we got, according to the interviews, half of the total effect of dampening down investment from this policy instrument. Investment tax took over the other half. So credit-rationing policies, with ceilings and liquidity requirements, and all that, had an effect which was quite large during that period. That is an example of possible effectiveness when using the measures drastically. But in the 1950-61 period, when the measures taken were not so drastic, the time lags were long and the effects were hardly visible. We carried out no interviews to study the effect, but perhaps if you had interviewed at that time investment might have been still larger than actually came out. But we know too little about this.

Also I should mention -- and I think I do say in my memo -- that conditions during the fifties were more difficult to manage by monetary policy means than we think they will be during the sixties, as we look at the sixties now. The inflationary anticipations were very strong in 1954 to 1957, when people were just geared toward the anticipation of rapid inflation and profits prospects were high and markets were booming. When people did not care so much for the cost of investment. It is very difficult to manage and prevent high booms by policy measures, and we have then to use quite drastic means. But as we look to the



sixties with, as we discussed before, the expectations of inflation much lower, and with much less of security among management as to markets expanding with greater fear of excess capacity, with more international competition, and all that, and with less possibility of self-financing because of the profit squeeze and higher dependence on the banks and capital markets, then the economy will tend to be much more sensitive to policy changes than it has been before. We have no real experience of this, but that is our hunch. So we may not need to take so drastic measures as we did in the booms of the 1950's; but we have not had any experience that I can present to you about these prospects for the sixties. However, the atmosphere is quite different now, and the dependence of corporations on outside finance will be higher and, therefore, the sensitivity to monetary policy changes will probably be greater.

COMMISSIONER LEMAN: So, in effect, you did not mean to generalize about the lack of effectiveness; it depends on the circumstances?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER LEMAN: Again, talking about what happens when you use monetary policy measures of the known direct interference type, the more general type of credit squeeze, did you experience in Sweden some shifts in the way credit is obtained in the economy? In other words, have you had the type of thing that has developed



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[Faint text]
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about what happens when you use monetary policy measures of the known direct interference type, the more general type of credit squeeze, did you experience in Sweden some shifts in the way credit is obtained in the economy? In other words, have you had the type of thing that has developed



1 here, this growth of what we call near banks? When
2 you put the squeeze only on commercial banks do you
3 find that gradually, if you give it time, people
4 will develop other means of getting their credit?

5 PROFESSOR LUNDBERG: Yes, we have had
6 that experience, but I do not think to the same
7 extent that you have had. We have not that type
8 of trust companies and instalment companies
9 receiving deposits and being free from regulations
10 that you have had here and in the United States.
11 The big corporations having excess liquidity
12 as deposits in the banks can also act as near
13 banks, and they did so to quite an extent during
14 1955-57, and again now, during 1959-61. They
15 will use their surplus deposits to help those
16 people delivering goods to them, parts of equipment,
17 and so on ---

18 COMMISSIONER GIBSON: Suppliers?

19 PROFESSOR LUNDBERG: Yes, suppliers.
20 That will happen to quite an extent so that you
21 will have a more effective use of surplus of liquidity
22 in times like these. That is a smoothing kind
23 of reaction to stringent policy. That is
24 quite good, but it is also making policy measures
25 much more effective.

26 We have also had experience, being a
27 small country, that the import of capital from
28 abroad has been interfering with the efficiency of
29 the monetary restriction policies. Exporting
30 companies have been able to get liquidity or



George Gurnea
George Gurnea

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of trust companies and installment companies
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the depression, and they were able to

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We have also had experience, being a
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abroad has been interfering with the efficiency of

the monetary system.

companies have been able to get liquidity or



1 payments more quickly when they are in a squeeze than
2 they otherwise would get. They have connections
3 abroad and will be or will try to be paid more
4 quickly than otherwise would be the case. In the
5 same way, some import firms in other credit markets
6 will get more credit for a longer period than
7 otherwise would be the case. We can also see
8 from the balance of payments, that our exchange
9 reserves change more rapidly than ought to have
10 been the case, according to the current items of
11 balance of payments, indicating some kind of
12 capital imports during times of credit stringency
13 in Sweden. That had a limited effect, but that
14 was a sign we have not complete autonomy, either,
15 over monetary policy. So we have that kind of
16 difficulty in Sweden, of making policy effective,
17 because of the increasing velocity of deposits
18 inside the country, and also some imports of
19 credit from abroad.

20 COMMISSIONER MACKINTOSH: May I ask if
21 you have a good deal of control over extensive
22 capital movement?

23 PROFESSOR LUNDBERG: Yes, we have, but
24 for the short term capital movement it can never
25 be effective and it is not meant to be effective.
26 refer
27 The controls/to the issuance of bonds and buying
28 of Swedish shares. But as to the short term
29 capital movement of credit on imports and exports
30 there is no control of that nature.

COMMISSIONER LEMAN: In your memo you



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there is no control of that nature.

COMMISSIONER LEMAN: In your memo you



1 explain that long term capital imports or exports
2 have not played a significant role in the Swedish
3 economy post-war. Is that just a fact, or part
4 of a policy to discourage any such long term
5 capital movements in or out of Sweden?

6 PROFESSOR LUNDBERG: I would say it is
7 part of the policy. If we had had a real, big
8 savings deficit and consequent need of capital from
9 abroad, because of very ambitious investment plans, we
10 would have, I think, seen to it that we have got
11 capital imports from abroad.



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1 Norway has done that to quite an extent. Norway
2 receives capital imports from Sweden, and to a certain
3 extent from other countries for investment in
4 shipping, for instance. But, in Sweden we have
5 not considered this as a need for the country.

6 Before 1913, before the First World War,
7 Sweden was a heavy capital importer for construction
8 of the railroads and housing and the building of
9 the cities, but since then it has not been, and
10 during the 20's we were net capital exporters.
11 Since then there has been no real great discussion
12 in Sweden about this. We feel, rather, we should
13 be capital exporters to under-developed countries.
14 In our last five-year plan, a certain part of our
15 savings has been allocated to net capital exports,
16 especially thinking of developments in under-
17 developed countries. But, we have no plans
18 of relying on capital imports.

19 COMMISSIONER LEMAN: You described earlier
20 that according to your concept the growth factor in
21 Sweden had been what you call quite moderate: do
22 you think capital imports would tend to raise this
23 rate somewhat, or not?

24 PROFESSOR LUNDBERG: I think it could,
25 yes -- possibly, yes. We could develop certain
26 sectors of our industries, especially if we have
27 direct investments, as you have, for instance, from
28 progressive German and French firms. I assume
29 we could accelerate the growth in this way. But,
30 we haven't considered that; we haven't thought it



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1 necessary or that we needed that kind of impulse from
2 abroad.

3 We have American branch plants and other
4 countries to a limited extent in certain fields --
5 in the chemical industry and in oil -- but it
6 plays a very minor role. We have not really
7 found we are in a bad position as to difficulties
8 of carrying out our growth policies in Sweden.

9 In Sweden, when we are discussing
10 associating ourselves with the European Common Market,
11 there has been a discussion about free capital
12 movements and the goodness and the badness of having
13 that, and Swedish opinion is very divided. You
14 will find a lot of people afraid of having Swedish
15 corporations governed by people in the Ruhr district,
16 or wherever it may be. On the other hand,
17 people have thought such capital imports and capital
18 investment would be a good balancing factor against
19 the socialist government; it would be less able
20 to do things because there would be capital flight
21 from Sweden.

22 What really happens is that the
23 uncertainty if Sweden will be associated, and the
24 uncertainty of whether the United Kingdom will be
25 associated, is that a number of big Swedish
26 corporations establish branch plants on the European
27 continent, just as the Americans do, and that is
28 also being discussed as a capital export that
29 might mean some difficulty in regard to a full
30 employment policy in Sweden.



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1 We are more aware of the problems you
2 raise now than we were before, but we have not
3 taken, I think, officially any stand on these very
4 big issues. We have not felt the need for net
5 capital imports. According to the expression of
6 Swedish opinion, you will find in the last five-year
7 plan, that was published last fall, that there was
8 an item of net capital exports as an expression
9 of what we consider a reasonable attitude towards
10 these problems.

11 COMMISSIONER LEMAN: But is it because
12 you feel it would interfere with the effectiveness
13 of control measures, or is it mostly an attitude
14 of a more nationalistic character?

15 PROFESSOR LUNDBERG: The word "we" is
16 very difficult in this connection. We are not
17 any "we" in Sweden on our opinions of this very big
18 issue. As I said, there are lots of people in
19 private business who would like it, from the point
20 of view, that it means the socialist government will
21 be less dangerous than it otherwise would be. If
22 we are more integrated with the European common
23 market the government will have to have in Sweden
24 a taxation policy that perhaps will be more in
25 conformity with Mr. Erhardt's views, and that would
26 provide for elbow-room for private business.

27 On the other hand private business would dislike
28 it at the same time when they think of Swedish
29 corporations being bought out by Ruhr firms, and
30 they do consider that a possibility. So, it is a

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1 schizophrenic attitude, and there is no settled
2 view. Of course, in the long run we know we will
3 be good Europeans, anyway, and we will be more or
4 less integrated, but the transitional period will
5 be difficult, and I think the reaction of the
6 majority of the people is nationalistic: "Sweden
7 is for Swedes". We have a policy set up of
8 a nature that is very different from the policies
9 in Italy, Germany and France, which we would like
10 to preserve; that is, the majority opinion, and we
11 do not like to be disturbed too much.

12 COMMISSIONER LEMAN: I can understand
13 why there could be different opinions in the country
14 etc., but the fact is that you do have a control
15 of long-term capital movements.

16 PROFESSOR LUNDBERG: Yes.

17 COMMISSIONER LEMAN: What are the
18 criteria used in administering this control? It
19 must be a policy measure, and there must be criteria
20 used in allowing certain capital movements?

21 PROFESSOR LUNDBERG: Yes, the criterion
22 is that we need no capital imports and that
23 Swedish shares should not be bought up by foreign
24 holders. That is the attitude now. I was
25 discussing more the prospects of a change in
26 attitudes that might be one condition for entering
27 the European communion. For my personal part,



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attitudes that might be one condition for entering
the European community. For my personal part,



1 and many Swedish people in the academic field would
2 say the same, we would like to have more of the
3 Viking attitude, entering the European scene as more
4 or less full members and trying to change Europe
5 according to our patterns. I think that would be a
6 more positive view, and there are progressive forces
7 in the United Kingdom and Germany and other countries
8 that would make it very feasible, and I think that
9 is a more positive point of view than trying to protect
10 us from influences we consider bad just for the time
11 being. Everything is in the flux of change, and the
12 Europe of Adenauer and DeGaulle is not the Europe
13 of 10 years ahead. We have to take part in big changes, and
14 if we are members, together with other countries, we
15 would have more possibility of shaping them according
16 to our own ideals than if we were standing outside.
17 However, the discussion is very vivid now in Sweden,
18 and it will become more so.

19 COMMISSIONER LEMAN: This may be a slight
20 deviation from the main subject of effectiveness,
21 but you have a sentence near the bottom of page 6
22 which I will quote:

23 "A conscious wage policy is also part
24 of the scheme, aiming at economically
25 justified wage relations."

26 You referred to that a little earlier. There
27 has been a lot of discussion in North America about
28 the adequacy of measurements of productivity, especially
29 in discussions with labour groups etc. Do you feel that
30 in Sweden you have arrived at satisfactory measurements



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1 of productivity in all important sectors?

2 PROFESSOR LUNDBERG: No, I am sorry we have
3 not, and we can never have that; it is impossible.
4 We have not shaped our Swedish industry in such a
5 way that manufacturers produce goods that can be
6 measured very well in quantity and quality. But we
7 would not like to have a policy of shaping Swedish
8 industry in order to get good measurements in
9 statistics. That is too ambitious an aim and would not
10 be accepted by the Swedish people.

11 When our big electric plants create
12 generators of a tremendous size, the turbines, and
13 so on, and quality and efficiency changes, and you
14 have to weight this volume with other engineering
15 products and compare that with the input factors of
16 labour and capital, you will never get a good measure
17 of productivity. Our ways of measuring are not
18 good and will never be. But, I think it is the
19 same if you take a human eye or ear: what we hear
20 and what we see is a very distorted and limited part
21 of reality. That is a fact, isn't it? Statistical
22 observations and techniques are just another way of
23 observing reality that is very unsatisfactory from
24 many points of view, just as the eye and ear. We have
25 to use that means of observation and kind of
26 communication when discussing economic development
27 and productivity. We need these very inefficient
28 instruments to get a picture of what is happening,
29 and we use these instruments of communication and
30 measuring progress and so on, and relative progress in



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1 in different branches of productivity. We try to
2 improve on them, but the measures will never be good,
3 but they are enough for carrying on sensible discussion
4 between people.

5 COMMISSIONER LEMAN: I understood you earlier
6 to mention the fact in certain industries productivity
7 can be measured a little easier than in others,
8 but in Sweden due to the pressure groups and high level
9 of organization of labour there has been a tendency
10 to equalize wages all over the country. In your
11 brief you mention this means, for instance, that
12 industries and firms with low productivity should not
13 be subsidized by having relatively cheap labour. But,
14 this equalization process, in effect, is a different
15 form of subsidization, isn't it, on various sectors of
16 the economy? If you artificially maintain wages in all
17 sectors where the productivity does not justify it,
18 you are subsidizing something, aren't you?

19 PROFESSOR LUNDBERG: No, that is not my view
20 on this issue. It is an important problem and it is
21 a philosophy that has been much discussed in Sweden.
22 This problem has nothing to do directly with measurement
23 of productivity. It is a kind of economic theory
24 about how the economy operates. The simple thought
25 behind it is that if firms and corporations in the
26 different branches of activity of the economy operate
27 and make their profitability calculations, and all that,
28 on the basis of uniform costs of the factors of
29 production over the whole economy, then there is a better
30 chance of efficient allocation of our resources in the



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1 direction of getting maximum productivity result than if
2 there is very unequal price of capital and labour in
3 the different sectors of the economy.

4 If, for instance, to take an example, the
5 engineering industry which in Sweden has the best wages
6 and is very highly productive from this point of view, if
7 investment people in this industry base their
8 calculations on twice as high wages per hour as the
9 marginal firms in the textile industry, then I think
10 that allocation of labour between the industries would
11 be less economic than if they had to pay the same price
12 for the same quality of labour in the two branches of
13 industry. If you have the wages for the same type of
14 labour in the marginal textile firms in relation to wages
15 in engineering then the textile firms will be able to
16 operate on these wages and keep on labour with a very low
17 productivity, with a very low added value. But the
18 best engineering firms, paying twice the wages, have to
19 have twice the productivity in order to keep labour on
20 and use it in their application. If we, therefore,
21 equalize wages so that the textile firms have to pay the
22 same wages as the engineering firms, then a number of
23 textile firms would say, "We can't pay these wages. It
24 is too expensive. We will have no profits. We don't
25 have that type of effective machinery, and so on", and
26 they will have to dismiss workers. Under full employment
27 conditions in the economy these workers will be taken
28 over -- if it has the right kind of skills -- by the
29 engineering firms. Then you will get an addition to
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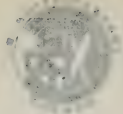
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1 the productivity of the economy as a whole. If the
2 textile industry paid half the wages and had very small
3 profits, and then these wage earners are transferred to
4 the engineering firms paying twice as much, this transfer
5 of labour will make an addition to the productivity of
6 the country that will not be available and apparent when
7 the manufacturers make their calculations if the wage
8 differentials are high. If the wages are much lower in
9 the textile industries, these industries will be sub-
10 sidized at the cost of the high productivity engineering
11 firms. It is from this type of philosophy on the effect-
12 iveness of the price and wage system that we get the
13 basis of the calculations of productivity, and these
14 profitability measurements would be able to show how best
15 to allocate resources. Such calculations can help in
16 mobilizing the labour force so as to shift it to the
17 expanding trades.

18 COMMISSIONER GIBSON: Is there an incentive
19 to move labour from one to another?

20 PROFESSOR LUNDBERG: Yes, that is an important
21 issue. From the discussions on that issue during
22 previous years -- and also in other countries -- you have
23 to have a high wage differential in order to make workers
24 move from the textile firms to the more productive eng-
25 ineering firms, and only if there is a high wage differ-
26 ential will there be reasons for workers to move. All
27 studies show however that there is very little incentive
28 for moving -- that people won't do it. American studies
29 by a number of people have shown how little incentive
30 there is for people to move from low wage industries to



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1 high wage industries as long as they have employment.

2 That is a weak argument for having wage
3 differentials. If such incentives work rather badly and
4 with low effectiveness, we consider the other aspect of
5 the problem of having the same price for the same quality
6 of labour all over the economy as being much more
7 important, and then using other means of making people
8 move. I mean, the best way of making people move is
9 squeezing an industry, and that is a more rapid way if
10 there are opportunities of being employed in other
11 industries. According to our views and experience
12 that is a much more effective set of instruments to make
13 labour move and shift from low productivity to high
14 productivity than a wage differential between occupations.

15 If we squeeze the textile industry in this
16 example by pulling up the wages more in parity with
17 engineering industries, and then if we have an active
18 labour market policy, making it easy for those people
19 having become unemployed to shift over to engineering
20 industries and paying them for travelling over there
21 and establishing themselves and getting a house, and all
22 that, that will also -- and having labour exchange
23 offices that keep all the information -- that will be
24 a more effective instrument of creating that shift of
25 labour source from low productivity to high productivity
26 than having wage differentials.

27 We have certainly not reached that kind of
28 perfect level of complete wage parity over the whole
29 economy. There are lower wages in textile industries,
30 and according to the statistics we have wage



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1 differences between the lowest and the highest in the
2 Swedish industry -- it is between 80 and 105 or 110 (100
3 = average) -- if we don't pay attention then to the
4 difference of frequencies of various skills in the
5 different parts of the industry. It is a rough measure
6 that shows that we are relatively far away from parity
7 employing exactly the same wage for the same skill in
8 the different trades. But in relation to what I see
9 in your statistics here, and in many other countries,
10 this is much closer to parity than in most other
11 countries. The trade unions in Sweden carry on a
12 conscious policy of reaching this aim of parity.

13 However, as I said in the beginning of this
14 hearing, the engineering industries for instance, are
15 responding rapidly and are having new mechanical devices
16 and are having rapidly increasing productivity and
17 wage rates are always taking rapid upward slides, tending
18 to go ahead with higher rates than in other branches
19 of industry, so it is difficult to catch up. It is
20 heavy work for the people in the older branches, the
21 trade unions of the textiles and the leather industries,
22 and so on, to really squeeze their own branches of
23 industry, pointing at the rapid development of wages
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1 COMMISSIONER BROWN: Would the same
2 philosophy apply to the narrow margins you mentioned
3 earlier existing between the skilled and unskilled
4 labour?

5 PROFESSOR LUNDBERG: Yes. During the first
6 post-war period there was a policy of trying to
7 squeeze these differentials between skills. You
8 know, the Swedes have a very strong feeling for
9 "justice" of a special kind, and unevenness of
10 distribution is one of the things that our socialist
11 policy and our taxation policy is aiming at
12 eliminating as far as possible. In the trade
13 unions the unskilled people have a higher number
14 than the skilled, so there was a cutting down of
15 the differential for the skilled people with bad
16 effects as to the supply of skilled people. But
17 the laws of income formation are stronger than
18 the conscious policies of the trade unions in their
19 efforts. When entrepreneurs are willing to pay
20 and the scarcity of people having the skills is
21 very great and the wage slides are very high, the
22 skilled differentials have been increasing. There
23 has been some efforts at job evaluations, as in
24 other countries, to find some kind of what people
25 consider correct changes, but there is a tendency
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1 COMMISSIONER MACKINTOSH: Historically
2 the skill differentials in Europe have been very
3 much less than in America?

4 PROFESSOR LUNDBERG: That is right,
5 and that is an expression of, I presume, partly
6 conscious trade union policy trying to keep them
7 down and partly also the higher relative skills in
8 America.

9 COMMISSIONER MACKINTOSH: I think
10 the original pattern came from the greater influx
11 of unskilled labour as against skilled labour by
12 immigration?

13 PROFESSOR LUNDBERG: That is possible, yes.
14 In America, you mean?

15 COMMISSIONER MACKINTOSH: Yes.

16 PROFESSOR LUNDBERG: Yes, I can understand
17 that. Of course, we would like to have less of
18 differentials between skills than is the case, but
19 I hope you people realize that it cannot be done
20 by force, because skilled people contribute so
21 much more to the productivity than unskilled.
22 To stimulate people to acquire skills, is a better
23 way of trying to keep down differentials, so that
24 the supply of skilled people increases in relation
25 to the demand. Increasingly much attention is
26 paid to vocational training, getting young people
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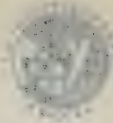
1 much lower if they are skilled.

2 COMMISSIONER GIBSON: In regard to
3 this policy of working towards wage equalization, are
4 you not possibly making a decision that the
5 industries that are declining are going on declining, and
6 industries that are advancing are going to continue
7 advancing; in other words, you are adding force
8 to the existing trend and you are preventing
9 the readjustment or recovery which sometimes
10 occurs, is that a fair statement?

11 PROFESSOR LUNDBERG: I think that is
12 very well expressed; I wish I could do as well as
13 you do. That is really what we think is very
14 necessary for having a rapid economic growth.

15 COMMISSIONER GIBSON: Suppose that
16 you are wrong and suppose that these industries
17 -- some of them -- do not go on growing
18 rapidly?

19 PROFESSOR LUNDBERG: Yes, there
20 are risks but, you know, we realize that we are
21 very human and make mistakes, and the thing is
22 only that we rely upon the visions of private
23 entrepreneurs in the various branches of the
24 industry. If the private firms have expansion
25 plans and are introducing new techniques and
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1 and they don't think they have a better insight
2 into what is the growth possibilities of industry
3 than the entrepreneurs have.

4 The government has to accept the private
5 investment plans and the expectations of the
6 rapidly growing activity and only try to see to
7 it that the entrepreneurs in growing sectors of
8 the economy get the kind of resources -- especially
9 of labour -- that they need for expansion and
10 this without scrutinizing the plans. I think
11 that will help the growth in Sweden very considerably.
12 It is a great help to growth to increase the
13 shift of resources by putting pressure on the
14 declining branches and firms -- making their
15 difficulties bigger by a rise of wages over the
16 whole land.

17 COMMISSIONER GIBSON: It is a
18 pretty tough policy for the weaker industries?

19 PROFESSOR LUNDBERG: Yes it is,
20 but I can give you a concrete example.

21 After the Korean war in 1951 we had
22 a recession, a slight recession in 1952, and
23 this especially referred to the textile industry.
24 That industry had been a growth industry during
25 the first years after the war -- people needed
26 clothing and the imports from other countries were
27 at a low level. The textile industry therefore
28 expanded their capacity very much during a
29 tremendous boom. The textile firms drafted
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1 labour and the government did not interfere with
2 that process. It was not a lasting expansion,
3 and from 1952 on the industry came into a
4 recession. When imports came in and import
5 competition grew heavily prices fell and wages
6 were rising, the textile firms were squeezed, and
7 they demanded protection. This was a rational
8 behavior from their point of view. Textile people
9 said that imports were dumped from abroad at too
10 low prices. The government didn't listen very
11 well and the textile trade unions -- and this is a
12 remarkable thing -- opposed protection against the
13 entrepreneurs. The trade union judgment
14 maintained that we don't like protection, we like to
15 work in an efficient industry. I have used
16 this example in Australia, to give effective
17 contrast to the Australian pattern of behavior
18 in a similar condition. When there are
19 difficulties in the Australian industry coming
20 into a special branch of activity then the trade
21 union people, and the entrepreneurs in the same
22 branch in an unholy alliance walk up to the
23 Tariff Commission and get protection. The
24 Australian industry tends to work along such lines.
25 The Swedish trade union leader who objected to
26 protection and said, "We like an efficient industry
27 and not a protected one", is still a leader.
28 The employment in the textile industry went down
29 to about 40 per cent in five years time, and the
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remarkable thing -- opposed protection against the
entrepreneurs. The trade union judgment
maintained that we don't like protection, we like to
work in an efficient industry. I have used
this example in Australia, to give effective
contrast to the Australian pattern of behavior
in a similar condition. When there are
difficulties in the Australian industry coming
into a special branch of activity then the trade
union people, and the entrepreneurs in the same
branch in an unholy alliance walk up to the
Tariff Commission and get protection. The
Australian industry tends to work along such lines.
The Swedish trade union leader who objected to
protection and said, "We like an efficient industry
and not a protected one", is still a leader.
The employment in the textile industry went down
to about 40 per cent in five years time, and the



1 workers could stand that because of their confidence
2 in the full employment policy. Of course there
3 were difficulties for the people in the textile
4 industry in getting employed, there were transfer
5 difficulties. But as there was excess demand
6 for labour especially in engineering and some
7 other industries partly at the same places the
8 unemployed were absorbed without much friction
9 in new occupations. The engineering firms
10 were happy to get hold of these people squeezed
11 out from the textile industries.

12 There was also new localization of
13 engineering plants with regard to availability of
14 textile workers. The labour board can give
15 valuable information as to where labour is
16 available. In Sweden we have a system that
17 an industry has to announce six months in advance
18 before laying down a plant. If there is excess
19 demand you will find the engineering plants will
20 try to locate a new branch plant in a district
21 where slack in employment exists or is expected.
22 So, I think that this squeezing out of labour in
23 the textile industry during certain periods has
24 helped the general productivity. I think all
25 this in a way is approaching a liberal dream of
26 a society that is efficient and where you make
27 resources quickly available to high productivity
28 and growth industries. But you are quite right
29 that the engineering industry in the long run might
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in the full employment policy. Of course there were difficulties for the people in the textile industry in getting employed, there were transfer difficulties. But as there was excess demand for labour especially in engineering and some other industries partly at the same places the unemployed were absorbed without much friction in new occupations. The engineering firms were happy to get hold of these people absorbed out from the textile industries.

There was also new location of engineering plants with regard to availability of textile workers. The labour board can give valuable information as to where labour is available. In Sweden we have a system that an industry has to announce six months in advance before laying down a plant. If there is excess demand you will find the engineering plants will try to locate a new branch plant in a district where slack in employment exists or is expected. So, I think that this squeezing out of labour in the textile industry during certain periods has helped the general productivity. I think all this in a way is approaching a liberal dream of a society that is efficient and where you make resources quickly available to high productivity and growth industries. But you are quite right that the engineering industry in the long run might



1 be making mistakes in the same way as the textile
2 industry before. It might happen that the
3 increased employment absorbed in the engineering
4 industry is not a lasting project. The people
5 expanding the plants are human and make mistakes.
6 But we have to rely on them and the play of the
7 free market. The people that work on the spot
8 and look at the profitability prospects should be
9 better aware of the tendencies of the market than
10 the government authorities.

(Page 4299 follows)



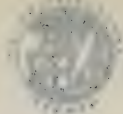
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(page #299 follows)



1 COMMISSIONER BROWN: In the 1960-61 boom,
2 when you used monetary policies of a more general
3 nature, was it your impression that it was availability
4 of money that was the factor, or was it the increase
5 in cost of money, or was it psychology? There was
6 a lag in these reactions, as you have described,
7 and they were not as effective as you had hoped at
8 the time, but you were pleased they were not so
9 effective. However, there must have been some
10 effect. Which had the greater effect, or do you
11 not have an opinion on this?

12 PROFESSOR LUNDBERG: We really do not
13 know very much about it. We have made no special
14 investigation as we did in the 1950's about the
15 effects. We have only the figures that show
16 that advances from the commercial banks were rapidly
17 going up during 1961, and that investment in
18 industry was increasing. We do not know how much
19 more investment would have gone up if these
20 measures were not taken. I am sorry, I am
21 not able to answer your question with greater
22 confidence. I am sure, with respect to marginal
23 firms finding themselves in difficulties as to
24 financing their investments, that they had to cut
25 them down, especially investments in inventories,
26 in order to finance themselves when they were
27 being squeezed. I think that investments during
28 these years were lower than they would otherwise
29 have been. How much was the effect from liquidity
30 ratios, and how much from an increase in the rate



when you used monetary policies of a more general nature, was it your impression that it was availability of money that was the factor, or was it the increase in cost of money, or was it psychology? There was a lag in these reactions, as you have described, and they were not as effective as you had hoped at the time, but you were pleased they were not so effective. However, there must have been some effect. Which had the greater effect, or do you not have an opinion on this?

PROFESSOR LUMBRIG: We really do not know very much about it. We have made no special investigation as we did in the 1950's about the effects. We have only the figures that show that advances from the commercial banks were rapidly going up during 1961, and that investment in industry was increasing. We do not know how much more investment would have gone up if these measures were not taken. I am sorry, I am not able to answer your question with greater confidence. I am sure, with respect to marginal firms finding themselves in difficulties as to financing their investments, that they had to cut them down, especially investments in inventories, in order to finance themselves when they were being squeezed. I think that investments during these years were lower than they would otherwise have been. How much was the effect from liquidity ratios, and how much from an increase in the rate



1 of interest is, of course, very difficult to say.

2 In the 1950's the rate of interest
3 increased by one per cent and played a minor role,
4 but that was only natural because the other measures
5 were so drastic. However, in 1960 and 1961 I
6 think an increase in the rate of interest of about
7 the same size had considerably more effect. In
8 power plant investment, for instance, the cost
9 of capital plays a very important role. At that
10 time also the market for electricity was more
11 balanced than it had been during the 1950's. When
12 you have a rise of rate of interest in a more
13 balanced situation then you have a sizeable potential
14 effectiveness on investment expenditure already
15 at one per cent rise in the rate of interest -- with
16 a time lag, of course. I think during the
17 1960's, when markets are more balanced, interest
18 rates will have a more important effect than they
19 had during the 1950's. But these are only
20 hunches, and we have made no serious investigation
21 into these possible effects.

22 COMMISSIONER BROWN: I have one
23 further question on commercial banks that comes
24 out of your remark about inventory financing.
25 During this period when we had a fairly consistent
26 increase in prices and when, therefore, firms
27 have required more financing in order to carry
28 the same inventory, has there been a permissive
29 regular rate of interest in advances by the
30



of interest in, or otherwise, any, whatsoever, or

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COMMISSIONER BROWN: I have one

further question on commercial banks that comes

up in connection with the monetary situation.

During this period when we had a fairly consistent

increase in prices and when, therefore, firms

have required more financing in order to carry

the same inventory, has there been a permissive

regular rate of interest in advances by the



1 commercial banks?

2 PROFESSOR LUNDBERG: By 'permissive' --
3 I do not understand that expression.

4 COMMISSIONER BROWN: In your controlling
5 of the advances that are permitted by the
6 commercial banks has the banks' cost of financing
7 inventories been a factor in your permitting such
8 increased advances?

9 PROFESSOR LUNDBERG: No, I do not think
10 so. With the inventories and the price
11 expectations you spoke of in the 1950's I think the
12 increase in interest rates plays a minor role.
13 It is really insignificant from this point of view.
14 But, with respect to credit availability, if
15 corporations have plans for investment projects
16 and they consider them very important, and they
17 continue these projects in spite of difficulties
18 in financing them, then they will look to cutting
19 down inventories and getting some money out of
20 them in order to finance the fixed investments.
21 That has helped to a certain extent. It is not
22 the rate of interest, but it is the availability
23 of finance that will affect the inventory
24 investment during such inflationary times. But,
25 you are also talking about the policy of the
26 commercial banks themselves?

27 COMMISSIONER BROWN: That is right, and
28 the policy of the central bank in controlling the
29 commercial banks?
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the policy of the central bank in controlling the

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1 PROFESSOR LUNDBERG: Yes. You cannot
2 differentiate -- of course. The central bank can
3 do very little or nothing with respect to how the
4 advances that are renewed or that are still being
5 used are distributed. The commercial banks do not
6 know this themselves. When they give an increased
7 advance to a corporation they do not have detailed
8 figures as to how the money will be used. The
9 bank has confidence in the corporations, and it
10 is up to the corporations to use the money in the
11 best way possible.

12 COMMISSIONER BROWN: I think you mis-
13 understand my question. In looking at the
14 increase in credit that is permitted by the
15 commercial banks is the factor of the increase in
16 price level taken into consideration by the
17 authorities?

18 PROFESSOR LUNDBERG: By the authorities?
19 No, it is not. When they put a ceiling on
20 advances for instance the central bank does not like
21 to consider that prices will increase. The central
22 bank would like to stop that increase, and, therefore,
23 in real terms the ceiling would mean that the volume
24 of advances outstanding would decline. So, from
25 that point of view the authorities do not accept the
26 fact of increased needs for advances just to cover the
27 consequences of increases in prices. That would
28 be almost the same as having them express an acceptance
29 of inflation.

30 COMMISSIONER BROWN: But they do accept it,



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1 in fact, do they not?

2 PROFESSOR LUNDBERG: That is quite another
3 thing from saying: "Now, we would like to restrict
4 bank advances, but we know that prices will increase
5 so we will give you just enough to cover the rise in
6 price". That would be the beginning of the end
7 of a central banker if he expressed himself in that
8 way. Of course, the commercial banks will complain,
9 pointing out that what the policy is doing when a credit
10 ceiling is set is that as prices and wages increase
11 there will be a greater squeeze on them than intended.
12 They would say that, and of course the central bank
13 authorities would retort: "Are we as good as that? We
14 are happy to hear that you are complaining because if
15 you should not be complaining then we would be going a
16 bad job". The Riksbank would thus never use expected
17 price and wage increases as a factor in allowing a
18 credit increase. They know that that will happen,
19 of course, but they will not take it into consideration
20 in advance. When prices have increased and they take
21 a new position after a year then they have to take
22 into consideration that the price rises have occurred,
23 and so shift their position.

24 COMMISSIONER BROWN: So they do it post
25 facto rather than ---

26 PROFESSOR LUNDBERG: Yes, but not explicitly.
27 You will never find it out in their statements, or
28 anything like that. It is the same with respect to
29 entrepreneurs pleading for more advances and more
30 credit from the commercial banks. They will point



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1 to the fact of higher values of inventories they have,
2 and the waiting costs of the fixed plants they are
3 erecting. They will say that investments are more
4 expensive than they were last year and that therefore
5 they need more advances of credit and higher limits than
6 they had last year. That attitude is natural and
7 necessary. The commercial banks will understand the
8 reasons, and if they have the cash they will accept
9 the claims, but if they have not the cash then they will
10 not accept them and will put on the squeeze. You know,
11 much of the policy of restricting a boom will be in
12 terms of not accepting the fact of the rise in prices.
13 The fighting of a boom is the fighting of a too rapid
14 increase in prices. But the fight usually is not very
15 effective. We agree on that.

16 COMMISSIONER GIBSON: Has the government
17 given any direction or advice to the banks, when
18 the banks have had to engage in these lending processes,
19 as to the kind of industries that ought to get the
20 credit.

21 PROFESSOR LUNDBERG: Yes they have done
22 that in a very general form. I think it is the
23 same type of form as in most other countries. When
24 the Riksbank explains or makes statements to urge
25 commercial banks and other institutions to hold back
26 credit advances it then expresses a general view
27 against speculative credits, instalment credits,
28 and so on. The banks are told they should be
29 especially careful in those directions, and are told
30 to favour credits for expanding export capacity for



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1 instance. You will find such statements especially
2 during the early post-war years.

3 COMMISSIONER GIBSON: Do they get the same
4 view from the trade unions that an expanding industry
5 ought to get more consideration than a weak industry?

6 PROFESSOR LUNDBERG: No. They know
7 the commercial banks watch for that themselves,
8 but you do raise an interesting point. These are
9 just loose statements in a general way, and are
10 statements which have not much effect on the carrying
11 out of policy, but there have been interesting
12 discussions in Sweden along the lines that you have
13 just suggested.

14 COMMISSIONER BROWN: I was merely asking;
15 not suggesting.

16 PROFESSOR LUNDBERG: Yes. The trade union
17 people have been complaining that the commercial banks
18 especially are protecting the weak industries in
19 Sweden. They say that the banks like to throw
20 good money after bad money in order to help weak and
21 unproductive firms in order not to lose money. They
22 say that if the banks were more rude, and tried to
23 see to it that there was more of failures and
24 bankruptcies in the Swedish economy, by not granting
25 credit to enterprises and firms that have not very
26 good chances of getting along, then savings could be
27 transferred to the more productive industries and
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Date

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have been attacking the commercial banks for not

being "capitalistic" enough -- for not trying to



1 maximize their profits by withdrawing money from the
2 bad firms and putting it in other directions.

3 The banks answer: "How do you know? We
4 think that this is a good industry or firm in the long
5 run and it will get over the difficulties if we help
6 them. We will take a chance. What will be the
7 results if a corporation which is a customer to a
8 bank finds out that when they are in financial
9 difficulties the bank backs out immediately? They
10 would not like to use such a bank, and that would mean
11 a lower rate of progress." There is the fact that
12 in Sweden the trade union people, have great
13 confidence in the government seeing to it that there
14 is full employment, and not much unemployment and
15 accept a shuffling of labour from one firm to another.
16 So they are not too much concerned if a bank carries
17 on a rude sort of policy and brings the "bad" firms
18 into bankruptcy.

19 This is an interesting problem because there
20 might be cases where the commercial banks really are
21 too slow and too kind to firms or branches of activity.
22 So, I think this kind of discussion is useful and should
23 go on. It is an interesting kind of discussion,
24 and I think the banks are right in answering that it
25 is not as easy as it seems. If a bank thinks a
26 firm is badly managed it may make it a condition
27 for the renewal of the credit that another man shall
28 manage the firm. Things like that are done from
29 the point of view of efficiency.

30 Perhaps the Swedish authorities are rather



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1 unique in these aspects. When one looks at the
2 American scene one gathers from their trade union
3 people that all they are interested in is security of
4 employment in such forms as a shorter working week.
5 The workers like to stay where they are, and they do
6 not so easily find opportunities for work in other
7 places. The attitude in two such countries as
8 U.S.A. and Sweden are quite different in these
9 respects.

10 COMMISSIONER GIBSON: This is a very
11 interesting argument, and not one we have heard very
12 much of here.

13 PROFESSOR LUNDBERG: I think it is a useful
14 discussion that is going on. My students, for
15 instance, often come to this problem. They see it
16 discussed in the papers. They often discuss the
17 belief that the commercial banks are protecting the
18 bad branches of activity and therefore braking the
19 rise in the productivity of Swedish industry. I
20 think the commercial banks are right in answering
21 these problems in the ways they do, but I also think
22 it is good for them to be irritated a little towards
23 higher efficiency in the use of capital.

24 On the other hand, we would like to see
25 that the government does something towards making
26 the credit market function with greater effectiveness.
27 In Sweden we should not only look at labour and
28 its efficiency, and increase its mobility with regard
29 to the more effective firms. We should also look at
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1 fashion, and having an effectively functioning credit
2 market with high mobility. That is an important
3 part of economic policy. The answer to that is
4 partly: take away our credit restrictions. Take
5 away the elements of direct control because they are
6 hampering free play on the Swedish capital market.

7 THE CHAIRMAN: We shall now adjourn until
8 2:15 p.m.

9 ---Luncheon adjournment.



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THE CHAIRMAN: We shall now adjourn until

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---(continued in)---

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1 --- On resuming at 2.20 p.m.

2
3 THE CHAIRMAN: We shall now resume.
4 Professor Lundberg, I think we would be very much
5 interested if you would give us some information
6 about the constitution and powers and activities
7 of the central bank in Sweden. I understand it
8 is quite different in some respects from the other
9 central banks. I may be wrong in that.

10 PROFESSOR LUNDBERG: Well, I think that
11 constitutionally it is rather different. Ours
12 is the oldest central bank in the world. It
13 came into being as a central bank in 1668; and it
14 became, from the beginning, a bank constitutionally
15 directly under the control of parliament. Six of
16 the members of the board of the bank are
17 appointed by parliament, and only one by the govern-
18 ment. The constitution of the bank was drawn
19 observing the fact that governments are apt
20 to misuse central bank power, for financing wars
21 and other escapades by printing money, and the way
22 of government is thus to use the central bank
23 for that purpose. Therefore, there was a reaction
24 against the government having the means of financing
25 its own extravagances by means of the central bank,
26 They wanted to guard against this by putting
27 the central bank under parliamentary power and,
28 constitutionally, it is still the case.

29 As I said, six of the seven members
30 of the board are appointed by parliament, and the



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PROFESSOR LUNDBERG: Well, I think that

constitutionally it is rather different. Ours is the oldest central bank in the world. It came into being as a central bank in 1688; and it became, from the beginning, a bank constitutionally directly under the control of parliament. Six of the members of the board of the bank are appointed by parliament, and only one by the government. The constitution of the bank was drawn

to misuse central bank power, for financing wars and other expedients by printing money, and the way of government is thus to use the central bank for that purpose. Therefore, there was a reaction against the government having the means of financing its own extravagances by means of the central bank. They wanted to guard against this by putting

constitutionally, it is still the case. As I said, six of the seven members of the board are appointed by parliament, and the



seventh by the government. . . . However, in reality, especially under the conditions we have had during the last 35 years -- or how many years is it since 1932? -- 30 years, with a socialist majority, or a close socialist majority, the government has also had control of the majority of the board. That means that the board has been quite close to the government in its general outlook. I can imagine, with this constitutional set-up of the Riksbank, that with a minority government, with a government coming into power after the socialists, there might be some disparity between the government and the central bank. We have however some experience that this formal independence of the central bank can mean something to the policy carried out. The last time it happened was in the summer of 1957 when, during the boom and the pressure on the economy, the board of the Riksbank increased the rate of interest by one per cent, without consultation with the government. Of course, they were constitutionally within their rights in doing that. The government was mostly on vacation, and the board took the opportunity of doing this; but the result was that the chairman of the board, who is appointed by the government, was dismissed. The Governor of the Riksbank is however still the same man. That was a small incident of the independence of the central bank. . . . Generally it has been the rule that the Riksbank consults with the government regarding major policy changes.



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1 So, the constitution is one thing. The
2 actual working is that the policy of the central bank,
3 of the Riksbank, is closely co-ordinated with the
4 government and therefore with fiscal policy. There
5 is very close cooperation between the finance
6 department and the Riksbank.

7 There was discussion in Sweden,
8 during the early post-war years as well as during
9 the inter-war years, to the effect that the Riksbank,
10 the central bank, should be responsible for the value
11 of money to a higher extent than the government
12 usually is, and that the Riksbank should pay special
13 attention to this policy aim. The government's
14 expansionary policy should be circumscribed and
15 checked by the Riksbank, guarding the value of money
16 by carrying out a stringent policy when the
17 government is too expansive. It was thought
18 that some government expansionist policies had to
19 be guarded against by the Riksbank, and that the
20 constitution should be made effective in practice
21 by allowing the Riksbank to "fight" government
22 policy.

23 That was a theoretical thought going
24 back in the history of doctrines, and had not
25 much practical application, except for the episode
26 in the summer of 1957.

27 As I have already said, there is rather
28 complete co-ordination of central bank and other
29 government policies. The central bank has its
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On the occasion of the meeting of the Board of Directors of the National Bank of Sweden, the following statement was made:

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expansive policy should be accompanied and checked by the Riksbank. Regarding the value of money

by carrying out a strategic policy when the Government is too expansive. It was thought

that some government expenditure would be so great as to be met by the Riksbank, and that the

constitution should be made effective in practice by allowing the Riksbank to "buy" Government

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back in the history of Government and had not much practical application, except for the episode

in the summer of 1931. As I have already said, there is rather

complete co-ordination of central bank and other monetary policy. The central bank has its



1 current duties, but when there are bigger issues
2 and problems involved they are always in close
3 consultation with the government, and especially
4 with the finance minister. This close alliance
5 between fiscal and Riksbank policy was confirmed
6 during the last years of the war, and during the
7 post-war years, when Mr. Dag Hammarskjold, the late
8 Secretary-General of the United Nations, was
9 secretary of the finance department and at the same
10 time chairman of the Riksbank Board. That was a
11 sign of the close co-ordination that started during
12 that time. Not having that kind of personal
13 unification, it is still the same kind of policy
14 that is carried out.

15 THE CHAIRMAN: As to the membership
16 of the board, from what group of people does
17 the government choose members of the board?

18 PROFESSOR LUNDBERG: The parliament
19 chooses.

20 THE CHAIRMAN: The parliament?

21 PROFESSOR LUNDBERG: Yes, and they choose
22 them from among politicians.

23 THE CHAIRMAN: Do you mean their own
24 members of parliament?

25 PROFESSOR LUNDBERG: Not necessarily,
26 not always -- no. I have even been a candidate
27 myself -- not very willingly, as a candidate of one
28 of the parties which would have liked to have me
29 in, though I have never been a member of parliament.
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1 It is the political parties, according to the weight
2 they have in parliament, that see to it that their
3 people are represented on the board.

4 Of course, you know how politics works.
5 It is a kind of remuneration for fine old men who
6 may not understand much of monetary policy but are
7 put into positions on this board, -- and I am sure
8 they learn a lot. Therefore, the Riksbank
9 has a strong hand. They can put the issues, and
10 the response from this board is very much along
11 the lines of the government having the power and
12 seeing to it that the major decisions are made
13 along the lines of the general government economic
14 policy. I am sure you will understand they are
15 not presumed to be experts at all; it is just a
16 case of laymen sitting in.

17 THE CHAIRMAN: It is somewhat similar
18 to the board that has been described to us of
19 the Bank of England, which is a board of people
20 who have different vocations and represent
21 different business activities -- trade unions
22 and other activities of that kind. But I do
23 not think they would contemplate appointing a
24 politician in England.

25 PROFESSOR LUNDBERG: But they do that
26 here.

27 THE CHAIRMAN: You have greater
28 trust in them, perhaps, than is exhibited else-
29 where.
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1 PROFESSOR LUNDBERG: I do not think so.

2 COMMISSIONER LEMAN: Professor Lundberg,
3 is there a statute which defines what duties the
4 bank has to perform?

5 PROFESSOR LUNDBERG: There is a bank
6 act, yes, but as to the general aims and management
7 of policy it is so generally worded that you cannot
8 read much out of it.

9 COMMISSIONER LEMAN: It is not precise?

10 PROFESSOR LUNDBERG: No, it is not
11 precise at all.

12 COMMISSIONER LEMAN: It does not
13 define these objectives we were talking about this
14 morning?

15 PROFESSOR LUNDBERG: No, it is worded
16 with a view to seeing to it that monetary
17 development and currency supply is according
18 to the needs of the country, and things like
19 that, giving a completely free interpretation for
20 those managing policy.

21 COMMISSIONER LEMAN: Does it use words
22 like, "the protection of the value of the currency"
23 -- and such?

24 PROFESSOR LUNDBERG: No, not in the Bank
25 Act, but it is taken up in the bank committee of
26 the parliament, where they stress and put down
27 the aims and policies of the Riksbank.

28 THE CHAIRMAN: What are the qualifications
29 of the governor?

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THE CHAIRMAN: What are the qualifications

of the governor?



1 PROFESSOR LUNDBERG: Excuse me, I did
2 not understand.

3 THE CHAIRMAN: What are the qualifications
4 of the governor? In choosing a governor is
5 there a fairly wide choice? Do they ever choose
6 a man who is not an expert to be governor of the
7 bank?

8 PROFESSOR LUNDBERG: Yes, it is a
9 completely wide-open choice. In the early days they
10 usually chose a man having had much experience in
11 banking, and appointed a man like Zvar Rooth, who then
12 became head of the Monetary fund. He had been
13 director or vice-chancellor of a private commercial
14 bank before that. After him they took an economist --
15 I do not know if you consider that as on an expert
16 level -- and, again, after that they took a man from
17 the civil service who had had much to do with the
18 finance department. The present governor came
19 from the trade union side, and was originally a forest
20 worker, having gone a long way in educating himself,
21 becoming a journalist, and after that coming into
22 government work, in a department that had nothing to
23 do with money and monetary policy. He was suddenly
24 appointed the governor of the Riksbank, having had
25 hardly anything to do with these problems. He was a
26 general civil servant at that time having acquired
27 a good general economic background knowledge and
28 administrative experience, but not an expert in
29 central bank matters.

30 THE CHAIRMAN: You do not always have

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1 an expert?

2 PROFESSOR LUNDBERG: No. Having had
3 this institution since 1668 you cannot avoid that.

4 There are a number of people in the Riksbank
5 who are steadily employed there, of course. Then you
6 have a board of directors who will know about these
7 things, and there is a close contact with the
8 commercial banks. But the government is completely free
9 in nominating the kind of man they think is reliable
10 and good from their point of view.

11 COMMISSIONER BROWN: What is the term of
12 appointment? Is it for the life of the existing
13 parliament, or for a fixed period of years?

14 PROFESSOR LUNDBERG: I am not quite certain,
15 but I think it is a rather short appointment -- some-
16 think like five or seven years -- but I do not remember
17 exactly how long it is. But there are of course re-
18 appointments.

19 COMMISSIONER BROWN: You mentioned the
20 possibility of a difference of opinion if there was a
21 change in majority in parliament and a change in
22 government. How would such a difficulty be resolved?

23 PROFESSOR LUNDBERG: The board members are
24 only appointed for a limited time period, and if
25 parliament changes occur and there are new groupings,
26 they will fall out and there will be a new board.

27 COMMISSIONER BROWN: So if there was any
28 difference of opinion this would be very short-
29 lived.

30 PROFESSOR LUNDBERG: Yes.



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PROFESSOR LUNDBERG: Yes.



1 COMMISSIONER GIBSON: It is just a little
2 group around the governor who are the people who really
3 make monetary policy? You described the governor
4 as being somebody outside, as a rule?

5 PROFESSOR LUNDBERG: Yes.

6 COMMISSIONER GIBSON: But who actually
7 formulates monetary policy from week to week and month
8 to month? Is there an executive committee around
9 him?

10 PROFESSOR LUNDBERG: Yes. There is
11 an executive committee, with a chairman, the governor
12 being the chairman; and there is a vice-governor,
13 and there is a deputy from the board also. They
14 are working together and meet each day and formulate and
15 carry out the current policy, and the whole board meets
once a week.

16 A discount rate change can only happen
17 at a certain weekday, because that decision has to
18 be taken by the board, after consultation with the
19 government. But there is an expert executive
20 committee, as you would call it, taking a stand
21 and managing the current policy.

22 COMMISSIONER GIBSON: Is there a group
23 of officials within the organization who constantly
24 discuss the matters and submit recommendations to
25 the governor and board?

26 PROFESSOR LUNDBERG: Yes, I would say so.
27 I am not an expert on the daily management of the
28 Riksbank. I am not in a position to say exactly
29 how they work. I worked once in the Riksbank, but
30 in a rather inferior position, so I do not know how it



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1 really happens. . . However, this executive committee
2 is just managing as any private company is managed,
3 by the expert people. . . The broader general
4 problems are taken up by the board, whether they
5 are political possibilities or impossibilities.
6 But management is going on in a closer circle, where
7 expert people are dealing with the problems.

8 COMMISSIONER GIBSON: What would you
9 say about the decisions as to which way monetary
10 policy should go at a given time -- are there any
11 ideas coming from among the staff?

12 PROFESSOR LUNDBERG: Yes. But it is
13 always difficult to judge exactly how outside
14 people being experts and having special departments
15 in the Riksbank will take up issues with the
16 governor, so that things are thought over and
17 initiatives are taken. But this can also come
18 from the government. The finance minister
19 especially is in contact with the broader issues
20 and will discuss the matter with the governor. It
21 is quite informal on that level of considering the
22 problems.

23 In parliament there is a special
24 committee of politicians watching monetary policy and
25 how the Riksbank is governed. They have
26 discussions and go over all the evidence of what
27 the Riksbank has done during the last year. They
28 present to parliament a survey and their opinions
29 and criticisms of how the Riksbank has been applying
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1 COMMISSIONER BROWN: Could you describe
2 to us the extent of the open market operations that
3 the bank undertakes, and do they normally operate
4 on a bills only or a bills preferably policy, or
5 do they have a process of operating through the
6 whole spectrum of maturities?

7 PROFESSOR LUNDBERG: Yes, they operate
8 on the spectrum of all maturities. If the Riksbank,
9 in co-operation with the national debt office, buys
10 or sells short or long term bonds, that is quite
11 an open question, depending on the situation.
12 There is no prevalent theory in Sweden of the
13 preference of only acting on the short end at
14 all.

15 COMMISSIONER BROWN: Have you yourself
16 got any thoughts on this?

17 PROFESSOR LUNDBERG: Well, I am no
18 expert in that field. I think you must consider that
19 in a country like Sweden, the credit or money market
20 or capital market is very imperfect and narrow,
21 there are sixteen commercial banks -- five big ones.



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1 There are no traditional dealers in bills or securities
2 along the lines of the big countries, and there are
3 many personal relationships, and so on, and a big
4 pension fund operating on the market. All this
5 means that we have little reason to believe in
6 any impersonal market mechanism where market forces
7 operate along the lines of the bills only doctrine.

8 I think the government is correct when it
9 likes to directly influence the long-term as well
10 as the short-term interest by direct operations.
11 Now, the Swedish market is so imperfect that when
12 the discount rate is changed, as a signal of the
13 changing of the intentions of the Riksbank, there
14 is usually no need as to market operations in order
15 to get the whole structure of interest rates to
16 follow up. It is a habit, more or less, that
17 commercial banks and savings banks all follow up
18 with about the same rate of interest changes.
19 The long-term rate of interest will change in the
20 same direction -- not exactly in the same way --
21 but more or less parallel over the whole field.
22 So, it is a rather simple procedure from this
23 point of view.

24 COMMISSIONER BROWN: Having control of
25 the capital issue market makes this control that
26 much more effective?

27 PROFESSOR LUNDBERG: Yes, and when new
28 issues are allowed by the Riksbank they also
29 determine the conditions of the issues, fitting into
30 their plans as to the long-term rate of interest.



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1 Of course, there is always some kind of outlook on
2 the market conditions: they have to have some kind
3 of contacts with what the insurance companies and
4 pension funds are doing, and their willingness and what
5 they would accept. There is always some kind of
6 notice taken of the market conditions even if the
7 market conditions are the result of the policy
8 carried out. During the last years the views
9 of the director of the big government pension fund
10 are very determining -- as to the conditions of
11 the issues. His views are determined by his own
12 supply of funds in relation to what kind of material
13 is available in the short run, and his views have
14 some effect on the conditions laid down. But in
15 the little longer run these conditions will be
16 changed or modified with the help of the government
17 policy.

18 COMMISSIONER BROWN: It is a picture of
19 a very well controlled market.

20 PROFESSOR LUNDBERG: Well controlled from
21 the point of view of the change of the rate of
22 interest, yes.

23 COMMISSIONER BROWN: You mentioned the
24 bank interest rates are tied by practice to changes
25 in the bank rate: is there any statutory limitation
26 on bank charges or bank interest rates?

27 PROFESSOR LUNDBERG: No, there are none of
28 that kind. They are completely free, except, as I
29 described this morning, there is a law in the background,
30 but in actual fact there are no ceilings on lending



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1 rate or deposit rates.

2 There is a lot of competition in this field,
3 although there are officially agreed rates of interest
4 charged for different types of advances of loans --
5 on a minimum level. There is a scale for different
6 kinds of mortgage loans and other kinds of securities.
7 They are more or less officially agreed upon by the
8 banking association in discussion after a change
9 in the discount rate. However, when you take up
10 loans of various kinds on risky kinds of corporations
11 or investment projects, and so on, the banks feel
12 rather free to take that kind of rate of interest
13 that they see fit -- within limits, of course; but
14 there is no ceiling on this.

15 COMMISSIONER BROWN: How does this
16 operate when the banks are being squeezed? Is
17 there a tendency for the interest rate to go higher
18 and higher and let the interest rate make a
19 decision as between various would-be borrowers,
20 or do the banks ration at fairly reasonable rates
21 of interest?

22 PROFESSOR LUNDBERG: You have both
23 tendencies. You have an increase in spread between
24 non-risk and risky loans. If a bank under heavy
25 monetary squeeze gives a more risky loan, they will
26 have a higher security premium than otherwise.
27 The highest rate of interest would be higher than
28 during non-squeeze time. On the other hand,
29 a lot of rationing is done, but the banks will not
30 increase the rate of interest very much. There are



rate or deposit rates.

There is a lot of competition in this field, although there are officially agreed rates of interest charged for different types of advances of loans -- on a minimum level. There is a scale for different kinds of mortgage loans and other kinds of securities. They are more or less officially agreed upon by the banking association in discussion after a change in the discount rate. However, when you take up loans of various kinds on risky kinds of corporations or investment projects, and so on, the banks feel rather free to take that kind of rate of interest that they see fit -- within limits, of course; but there is no ceiling on this.

COMMISSIONER BROWN: How does this

operate when the banks are being squeezed? Is there a tendency for the interest rate to go higher and higher and let the interest rate make a decision as between various would-be borrowers, or do the banks ration at fairly reasonable rates of interest?

COMMISSIONER BROWN: You have an increase in spread between non-risk and risky loans. If a bank under heavy monetary squeeze gives a more risky loan, they will have a higher security premium than otherwise. The highest rate of interest would be higher than during non-squeeze time. On the other hand, a lot of rationing is done, but the banks will not increase the rate of interest very much. There are



1 narrow limits in this increase of the highest rate
2 of interest -- with the guaranteed costs that are
3 put on the loan.

4 COMMISSIONER BROWN: How about changes in
5 cash reserve requirement?

6 PROFESSOR LUNDBERG: By the Riksbank?

7 COMMISSIONER BROWN: Yes.

8 PROFESSOR LUNDBERG: On the commercial
9 banks: The Riksbank can agree to a special rate that
10 is included in the law of liquidity ratios, prescribed
11 up to 15 per cent cash ratio to total deposits, but
12 the Riksbank has never applied this law -- not even
13 in the form of "voluntary agreements" -- they have
14 only used the liquidity ratio so far. It is a
15 potential rule. Now the banks are completely free
16 to use the cash ratio they like or which they think is
17 good for them and are of course eager not to lose
18 interest by keeping unnecessary cash. They keep
19 rather low cash ratios, but they have a rather high
20 liquidity ratio in the wider sense of the word, which
21 they can easily transform into cash. Depending on
22 the kind of business the bank is carrying out, you
23 will find the cash ratios between the banks are rather
24 different, and that is within their own management
25 discretion. However, potentially there is a law,
26 so that if we don't use the liquidity ratio we can
27 use the cash ratio. Liquidity ratio is very much on
28 the line of paying consideration to the priorities, to
29 see to it that enough flows to government investments,
30 and into house-financing. If we should apply

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1 only a cash ratio the banks will be freer to apply
2 the loans and advances and investments freely
3 without priorities. So, we hope -- and it has been
4 expressed from government circles -- that this cash
5 ratio may be applied in future when it is not needed
6 to use the more restrictive method of liquidity
7 ratios. We think the big pension fund, which is placing
8 its increasing volume of funds into government and
9 housing papers, will see to it that that market is
10 well supplied with funds, and therefore the banking
11 system, the commercial banks, can be kept freer and
12 be regulated just by prescribing cash ratios.

13 COMMISSIONER LEMAN: You said that there
14 was quite a discrepancy in cash ratios between one
15 institution and the other: have you observed whether
16 within each of those institutions there is a great
17 fluctuation in their cash reserves from one time
18 to the other?

19 PROFESSOR LUNDBERG: Well, I have not
20 observed it, but I would think there is not too much
21 of it because I think that is the job of a bank
22 manager and his investment men, to see to it that the
23 bank does not lose unnecessarily too much income by
24 unnecessarily having too much cash, depending on
25 the kind of risks they take and the kind of
26 opportunities for which they like to have cash.
27 There may be fluctuations in time, but I would not
28 think they would be very big.

29 COMMISSIONER GIBSON: I would like to go
30 back to the liquidity ratio again. The liquidity ratio



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think they would be very big.

COMMISSIONER TROSKY: I would like to go

back to the question of the liquidity ratio.



1 includes as liquid assets, does it, all forms of
2 government securities?

3 PROFESSOR LUNDBERG: Yes.

4 COMMISSIONER GIBSON: Including monies
5 for housing guaranteed by government.

6 PROFESSOR LUNDBERG: Yes, bonds issued by
7 these institutions which work with a government
8 guarantee; and the foreign exchange is also included,
9 that the banks might have.

10 COMMISSIONER GIBSON: The way you put it
11 I rather got the idea that the philosophy of the
12 liquidity ratio was to see the banks put enough of
13 their resources into government sponsored things rather
14 than to limit the amount of the resources that went
15 into the private sector: is that a correct statement?

16 PROFESSOR LUNDBERG: I would not put it so.
17 Why could we not say it is both?

18 COMMISSIONER GIBSON: Well, I just want to
19 ask you.

20 PROFESSOR LUNDBERG: If we are in a
21 position where we are afraid of over-investment --
22 excess demand in our economy -- we like to try to
23 depress this kind of boom by limiting the availability
24 of finances for these investments. At the same time
25 we like to preserve government investments and
26 investments in housing from this squeeze. Then, we do
27 both: we preserve, and see to it that not too much of
28 this pressure occurs on these fields of priority, and
29 that the squeeze falls on the rest of the economy.
30 Therefore, I would say in answer to your



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that the squeeze falls on the rest of the economy.

Therefore, I would say in answer to your



1 question that we are in those conditions aiming at both
2 these things.

3 COMMISSIONER GIBSON: Surely it has little
4 to do with bank liquidity.

5 PROFESSOR LUNDBERG: It is a very bad word,
6 isn't it? It is a misuse of the word liquidity, and
7 I think the wording should be changed, because it is
8 really not liquidity in any sensible interpretation
9 of the word. However, it has entered into the law and
10 it has been accepted and it is difficult to change it.
11 Foreign students of Swedish banking may misinterpret
12 it and find it strange.

13 COMMISSIONER GIBSON: I think the idea is
14 held elsewhere too.

15 COMMISSIONER BROWN: Are the government
16 accounts kept in commercial banks as well as the
17 Riksbank, or only at the central bank?

18 PROFESSOR LUNDBERG: If you are speaking
19 about the administration units of the government, all
20 their accounts are kept in the Riksbank and their
21 offices around the country. Then we have, of course,
22 state corporations such as the water power board, and
23 the state railroads, and so on -- the commercial kind
24 of non-corporation units -- that are very big and
25 important, and they keep all their money in the state
26 commercial bank. There is a state commercial bank --
27 a very big bank -- which was created some years ago,
28 and these units have to keep their money in that bank
29 for current purposes.

30 COMMISSIONER BROWN: Does this bank do ordinary



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COMMISSIONER BROWN: Does this mean the



1 commercial business as well?

2 PROFESSOR LUNDBERG: Yes, it is very active.

3 It is so competitive, and they have a management and
4 a director who is just dangerous as far as the others
5 are concerned. He is carrying on without direct
6 profit motives or anything like that with great energy.
7 You will find lots of complaints about the state
8 commercial bank in this private business. Some say
9 that by getting all this government money, it is
10 favoured. The state bank takes part only as
11 sleeping partner in the bank association meetings in the
12 forming of rates of interest and so on. The bank
13 seems always on the point of breaking agreements and
14 is in all ways very competitive, with branch offices
15 and new innovations in the banking field. We think
16 the state bank, if it has no other special favours
17 should act competitively.

18 COMMISSIONER BROWN: Does it get squeezed
19 the same as the others?

20 PROFESSOR LUNDBERG: Yes.

21 COMMISSIONER BROWN: Does it pay income
22 tax?

23 PROFESSOR LUNDBERG: Oh, yes.

24 COMMISSIONER BROWN: Has it been growing
25 at the expense of the ordinary commercial banks?

26 PROFESSOR LUNDBERG: Yes, in a way it has
27 been growing more rapidly than the others during
28 these years, partly because of getting during this time
29 funds from the government enterprises, and partly also,
30 I think, as a result of direct competitive leadership.

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from the sale of its own securities.



1 People mostly are sorry both if a state
2 enterprise is operating badly and declines and also if
3 it is efficient and competitive and grows. However,
4 if you have to make a choice, I think it is better
5 to have an effectively managed and energetic lead
6 state company, provided it is not getting special
7 favours and subsidies.

8 THE CHAIRMAN: Do you happen to know off-
9 hand what is the average maturity of the long-term
10 debt?

11 PROFESSOR LUNDBERG: No, I have not the
12 figures here.

13 THE CHAIRMAN: It may not be too important;
14 I was just interested.

15 PROFESSOR LUNDBERG: We have a rather small
16 total government debt. It is just one quarter of the
17 gross national product. I think the English have
18 one and a half times the gross national product. So,
19 it does not bother us, so much, and the debt management
20 has not been the same type of severe problem as in
21 other countries. Sweden did not take part in the
22 wars, and have not that type of problem to the same
23 extent as in so many other countries, and therefore
24 our total debt is not so high.

25 However, I presume a relatively large part
26 is funded debt, more than 10 years, or something like
27 that; but I could not say exactly how much of it.

28 THE CHAIRMAN: You mentioned, I think, at
29 an earlier stage that there are certain institutions
30 which you call near banks in Sweden. Have you any



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THE CHAIRMAN: You mentioned, I think, at

an earlier stage that there are certain institutions

which you call near banks in Sweden. Have you any



1 means of controlling their activities, or do you attempt
2 to do that at all?

3 PROFESSOR LUNDBERG: I think our definitions
4 of "near banks" is not so very clear. You would not
5 call a savings bank a near bank; it is just a bank.

6 THE CHAIRMAN: Well, finance companies: are
7 these hire-purchase companies in Sweden?

8 PROFESSOR LUNDBERG: We have hire-purchase
9 institutions.

10 THE CHAIRMAN: Do they finance consumer
11 goods?

12 PROFESSOR LUNDBERG: Yes, and discount the
13 bills of the traders in these fields, and it is a
14 growing business in Sweden.

15 THE CHAIRMAN: Do you regard it as a
16 problem at all?

17 PROFESSOR LUNDBERG: We have problems with
18 them. We like to have problems; that is creating
19 progress. I think competition in this field is good,
20 but the big difference from the Canadian and American
21 situation is that these institutions have not the right
22 to accept deposits. That is the main difference, and
23 therefore they have not this position of near banks.
24 These institutions get nearly all of their money by
25 discounting bills with the commercial banks, and they
26 get their funds mainly from the commercial banks. So,
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1 THE CHAIRMAN: Do you have any powers to
2 control their activities in any way?

3 PROFESSOR LUNDBERG: Yes, that has been more
4 or less so from the beginning, that the Board of Trade
5 has limited rights to prescribe the cash payments and
6 the maturity of instalment credits -- the length of the
7 contract in these fields. This right of prescription
8 hasn't been used as in England as a current policy
9 measure. Our experience is that when the Riksbank
10 squeezes the commercial banks that that works back
11 on the bank credit to instalment credit firms because
12 they get the money from the commercial banks.
13 We have, therefore, not from this point of view had
14 the same problem as you have had. With relation to
15 the savings banks, the farmer credit institutions and the
16 insurance companies, and so on there are possibilities
17 of regulation according to the law to prescribe both
18 liquidity ratios of a type but which are not so high
19 as for the commercial banks, and also there are in the
20 law possibilities of prescribing what we call
21 investment quotas so that insurance companies, and so
22 on, have -- during those times when this law is
23 applied -- to use up to 80 per cent, I think, of the
24 increase of these funds during a certain time for a
25 priority investment in government papers and in the
26 housing financing bonds. Potentially the
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2 I doubt it will be applied; it is only, again,
3 the background for making "voluntary agreements" with
4 these institutions. Already before this law
5 existed the Riksbank made agreement with the
6 insurance companies, for instance, as to helping the
7 commercial banks and the other institutions in
8 placing their funds into the priority sectors of
9 the economy. So from this point of view the
10 commercial banks have not felt that they alone have
11 been under pressure during times of monetary
12 squeeze.

13 However, it is true in Sweden, as in
14 Canada, that the commercial banks have been under
15 more pressure during monetary squeeze times than the
16 other institutions. It is quite natural that
17 that happens. On the other hand, there are
18 also times when there has been no pressure or
19 monetary squeeze and the commercial banks have been
20 growing more rapidly than the other institutions,
21 so it has been evened up over the years.

22 THE CHAIRMAN: Well, from the point
23 of view of monetary policy would you think that
24 there would be need to regulate some of these near
25 banks, such as we have in this country, on a fairly
26 large scale; to regulate them so that their
27 activities may be cut down at certain times and
28 allowed to expand at other times, consistent with
29 your general monetary policy?
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your general monetary policy?



1 PROFESSOR LUNDBERG: Are you speaking
2 of Sweden or Canada?

3 THE CHAIRMAN: It perhaps would apply
4 more to Canada than to Sweden, according to what
5 you have said about the Swedish situation at the
6 present time, because here we have credit unions
7 which have very large funds that have been built
8 up over the years, and they borrow and they lend
9 money ---

10 PROFESSOR LUNDBERG: Yes.

11 THE CHAIRMAN: I don't know whether it
12 is fair to ask you whether you think ---

13 PROFESSOR LUNDBERG: I am just an
14 irresponsible professor; I am not afraid of
15 answering questions!

16 THE CHAIRMAN: I was asking you this;
17 I put this question to you as an economist, not as
18 a professor.

19 PROFESSOR LUNDBERG: I don't know the
20 difference but, anyhow, my personal view is that if
21 your near banks are of that character as I have
22 read about in your documents, that they accept
23 deposits, I would consider them as banks, and I would
24 say that to me it is strange in not applying the
25 same rules to all the banks accepting deposits
26 and putting them under the equal squeeze. Our
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1 I can't understand your ceiling rates,
2 neither; I think that is very strange, applying it
3 sometimes on banks you call commercial but not on
4 other types you don't call banks. Such things I
5 don't understand. That is as difficult for me to
6 understand as you have of understanding some of our
7 ways of doing things; I am sure we all have our own
8 idiosyncrasies.

9 THE CHAIRMAN: That is one of our problems.
10 Now, there is one last question which I would like to
11 ask and that is in connection with the international
12 exchange rate. You have to fix your floating rate,
13 or something in between?

14 PROFESSOR LUNDBERG: We have a fixed rate
15 according to the monetary fund rules and, we have a
16 discussion on the flexible rate on a very academic
17 level but never as a practical policy issue. We
18 devalued our crown following the British pound in
19 1949, and since then we have kept a stable value
20 on the Swedish crown, much under-valued during that
21 time; we got perhaps some of our inflation out of
22 that but we also got a relatively favourable position
23 for our export industries and some protection for
24 home goods industries, thanks to this kind of under-
25 valuation of the crown. But, again from the point of
26 view of the aim of preserving the value of money, it
27 was bad because it created an increase of import and
28 export prices that resulted in our rapid increase of
29 the price level.

30 COMMISSIONER MACKINTOSH: I would like to



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PROFESSOR LUNDBERG: We have a fixed rate
according to the monetary fund rules and, we have a
discussion on the flexible rate on a very academic
level but never as a practical policy issue. We
devalued our crown following the British pound in
1949, and since then we have kept a stable value
on the Swedish crown, much under-valued during that
time; we got perhaps some of our inflation out of
that but we also got a relatively favourable position
for our export industries and some protection for
some goods industries, thanks to this kind of under-
valuation of the crown. But, again from the point of
view of the aim of preserving the value of money, it
was bad because it created an increase of import and
export prices that resulted in our rapid increase of
the price level.

COMMISSIONER MATHIASSEN: I would like to



1 get a clearer idea of some of your monetary devices
2 and the patterns of action which you took. You
3 mentioned this morning the 12 per cent investment tax
4 which was put in in 1955. Does this mean 12 per cent
5 on the investment expenditure?

6 PROFESSOR LUNDBERG: Yes. You know, I
7 should be more specific, perhaps, than that; it was
8 12 per cent on expenditure of investment in buildings,
9 machinery and similar expenditures, not on investment
10 in stocks or inventories, and there was a limit of
11 20,000 crowns, so that there was -- a deduction of
12 20,000 crowns; firms having less investment didn't pay
13 the tax at all.

14 COMMISSIONER MACKINTOSH: Was there prior
15 legislation which enabled the government to impose
16 this tax quickly?

17 PROFESSOR LUNDBERG: No, there has to be
18 a new law for each time. The government proposal
19 has to go through the whole process of a proposition
20 to parliament and be put into force. But, having
21 a socialistic government during these years and
22 relying on the majority that can be mobilized in
23 parliament, it is a very quick affair of a fortnight
24 to put an investment tax into effect. The main thing
25 I have stressed in this memo on the investment tax was
26 the experience of industry that this was never intended
27 to be a permanent tax.

28 We often do not believe in finance ministers
29 when they say that this is a tax just for a short
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1 finance ministers all over the world, that when a tax
2 is introduced it tends to be permanent as it is
3 needed. But in this case industry had the experiences
4 of this tax being introduced and taken away, so they
5 believe in it, and therefore there was a kind of
6 expectation that it would disappear after the boom,
7 and that is where we get the postponement effect.
8 Had people believed that this was a permanent tax
9 it would have been built into our price system and
10 just made our economy still more inflationary.

11 COMMISSIONER MACKINTOSH: It was a very
12 powerful weapon to wield.

13 PROFESSOR LUNDBERG: Yes, and it was
14 not popular, you know! Anyhow, from the
15 socialist point of view it is in a way the most
16 wonderful kind of an expedient. You know, in our
17 investment boom one likes to make investment
18 expenditure more expensive than otherwise would
19 be the case. An increase in the rate of interest
20 very much means from the socialist point of view
21 -- that a lot of people get more income out
22 of the higher yields and the higher rates of
23 interest in the economy, but in this way it was
24 an increase in investment costs without anybody getting
25 any higher income out of it. I know from
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1 taken away again very quickly.

2 You discuss in this country and in the
3 United States so much the devastating effect on your
4 capital markets and of large increases of long
5 term interest rates that will create quite
6 embarrassing situations, as was the case in 1958.
7 This investment tax has no effects along this line;
8 it works completely independently on the prices of
9 the bonds in the capital markets, and this is
10 something appealing from this point of view, that
11 there is no confiscation of fortunes of people.
12 From the point of view of your way of doing things
13 -- if the interest rates were raised very rapidly,
14 if you thought of that two or three per cent, the
15 average of the prices on the bonds would mean
16 a radical confiscation of people's fortunes. What
17 is more socialistic our ways or yours, I don't
18 know.

19 COMMISSIONER MACKINTOSH: I see your
20 logic, but I haven't much hope of officially
21 protesting against high interest rates.

22 PROFESSOR LUNDBERG: The interesting thing
23 as I see it is that it is the socialist people
24 and the trade union people who are supporting the
25 government in this field; they are more in
26 favour of using the investment reserves or the
27 investment fund policy than the investment tax,
28 although the investment fund way of doing things
29 is very favourable to private corporations.
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3 COMMISSIONER MACKINTOSH: I wanted to clarify
4 the investment reserve policy a bit, which I found
5 to be a very interesting device. This is essentially
6 the setting aside of profits without tax into a reserve
7 which can be used only when the labour market board
8 says it can be released. I don't quite understand the
9 later period here where you mention -- well, there are
10 two points; one, they are required to deposit roughly
11 the tax part of this in the Riksbank?

12 PROFESSOR LUNDBERG: Yes.

13 COMMISSIONER MACKINTOSH: There was inducement
14 to them to deposit more than that, and there was also
15 reference to a further 10 per cent -- was it a tax?
16 It is on page 13, and this is the sentence which begins
17 at the bottom of page 12:

18 "An extra stimulus to use this device
19 is given by a 10 per cent deduction from
20 taxable profits of the investment fund used."

21 PROFESSOR LUNDBERG: Yes.

22 COMMISSIONER MACKINTOSH: This applies only
23 when the funds are released ---

24 PROFESSOR LUNDBERG: And used, yes.

25 COMMISSIONER MACKINTOSH: And then they can
26 write off 10 per cent of it against the profits of that
27 year?

28 PROFESSOR LUNDBERG: Yes and if the corporation,
29 as is the case -- just now in these current months
30 the labour market board has given corporations the right

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1 to use the investment funds for writing off invest-
2 ments, and it applies during the year and up to May
3 of next year. If, for instance, a corporation
4 uses investment funds up to one million crowns, it
5 could have the right to use 10 per cent of this, or
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1 In a new proposal it is now suggested --
2 this system of investment funds has been worked
3 over by a committee -- this extra deduction of
4 ten per cent of the investment fund used will be
5 eliminated because they consider that this free
6 rate of writing off building expenditure is enough
7 stimulus. There has been a big wave of
8 applications for using investment funds during this
9 year. This use of investment funds is really
10 a very liberal way of being able to write off
11 buildings that otherwise would have to be written
12 off in 33 years' time, and which now can be written
13 off immediately.

14 COMMISSIONER MACKINTOSH: Does this
15 apply to corporations and also to small
16 businesses?

17 PROFESSOR LUNDBERG: It applies to
18 corporations and what we call economic unions which
19 are not the ordinary corporate kind of firms.

20 COMMISSIONER LEMAN: Co-operatives?

21 PROFESSOR LUNDBERG: Partnerships. Firms
22 that set aside investment funds can deduct these
23 from the profits, and therefore they get the right
24 to write off investments that they are not allowed
25 to make until later. The National Labour Board
26 gives that allowance during a recession. In
27 order to neutralize that liquidity effect the
28 corporation has to pay part of the fund (46 per
29 cent) into the Riksbank and thus sterilize it for
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 cent) into the Riksbank and thus sterilize it for



1 the time being. Corporations are allowed to set
2 off an amount corresponding to 40 per cent of the
3 profits.

4 COMMISSIONER LEMAN: Professor Lundberg,
5 in granting permission for the use of these
6 investment reserve funds does the board again have
7 the chance of being selective?

8 PROFESSOR LUNDBERG: No, it does not.
9 There are two features of this law that I have not
10 mentioned. One is that it is possible to make it
11 compulsory. The Labour Market Board can say that
12 during this time all corporations which have set
13 off investments funds must use parts of them for
14 investment expenditures, otherwise this part will
15 be made subject to taxation. This compulsory
16 provision has never been used, and it has not
17 been necessary to use, but one can imagine the
18 situation when the list of the entrepreneurs
19 wanting to use the funds is low: when there is
20 a depression there may be a need to use the
21 compulsory part of it. So far as I know from
22 speaking to the people who manage this kind of
23 policy, they have no intention of using this
24 provision. They cannot imagine a situation
25 where the compulsory part will be used.

26 COMMISSIONER MACKINTOSH: It would
27 hardly ensure a perfect allocation of
28 resources?

29 PROFESSOR LUNDBERG: No, but it is not
30



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COMMISSIONER LEWIS: Professor Lumberg,

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UNSUBSCRIBED: That is all.

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PROFESSOR LUMBERG: No, but it is not



1 a very bad measure. We have a lot of corporations
2 who avoid the taxation, but now we are making them
3 pay the tax. They have to make the investment
4 or pay the tax. They have the choice. As it
5 is now I think there are up to a thousand corporations
6 applying to use their investment reserve funds,
7 and they have to make it clear that the use of
8 these funds means investments being made that
9 would not otherwise have been made. That is, of
10 course, not so easy, and we are sure that a lot of
11 investment made would be made anyhow.

12 The taxation authority looks the matter
13 over and controls the expenditures, and sees to it
14 that they are made during a time when the labour
15 board considers there are recessional problems.
16 The labour board has now limited the period up to
17 May of 1963 because it knows that during the summer
18 there will anyhow be lots of employment possibilities
19 in the Swedish economy.

20 There is the possibility, according to
21 this law, of applying it discriminately so that
22 it will apply to special sectors of the country
23 where there are special recessional tendencies.
24 This would be applicable to the Swedish situation
25 now. In the north of Sweden there is more of
26 a recession than in the south. A recession is
27 expected there because of difficulties in the pulp
28 and paper industries, and especially in forestry,
29 so that actually the national labour board should
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There is the possibility, according to this law, of applying it discriminatorily so that it will apply to special sections of the country where there are special recessionary tendencies. This would be applicable to the Swedish situation now. In the north of Sweden there is more of a recession than in the south. A recession is expected there because of difficulties in the pulp and paper industries, and especially in forestry, so that actually the national labour board should



1 have this benefit of allowing investment funds of
2 corporations in the north of Sweden to be used.
3 They have considered this and discussed it with the
4 government. But the problem is that the corporations
5 in the north of Sweden are having difficulties
6 already in selling and having surplus capacity,
7 so that being so the use of funds would not have
8 great results.

9 The labour board also considers it not
10 good to use the law in a discriminatory way because
11 there are always difficulties with respect to
12 boundary lines. People will lose confidence in
13 the use of this measure with respect to investment
14 funds if during certain times one corporation
15 situated in one place has advantages over a
16 corporation situated elsewhere. They like to use
17 the measure as generally as possible at any given
18 time. Now that they have made its use applicable
19 to the whole of the Swedish economy we are getting
20 a building boom in the south of Sweden. There
21 are not enough building workers in the south.
22 A number of corporations are getting on with
23 the building of new plants to quite an extent in the
24 south of Sweden. The consequence is that now we
25 are encountering the problem we discussed this
26 morning. The national labour board, with the help
27 of its local authorities, has to see to it that
28 building workers, or people who are able to do
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1 So, this stimulation of the economy by using the
2 investment funds is closely connected with a policy
3 of moving workers who are unemployed during the
4 winter season in the north of Sweden to parts of the
5 country where they can be employed. That is a rather
6 new feature to this extent, that the policy is to use
7 people who are not yet unemployed, but who expect to
8 be unemployed. By means of the warning system the
9 Board knows that building work will release labour
10 within so many months, and these people are already
11 prepared. This is a very ambitious kind of policy,
12 and we do not know to what extent it will be effective.
13 But it illustrates the difficulty faced by a small
14 country like Sweden where the tendencies towards
15 development are uneven in the various regions. If you
16 apply global methods to the whole of the economy you
17 get into difficulties, and, therefore, you must
18 supplement this measure by some means of getting
19 workers moving out of regions of low demand into
20 regions of high demand.

21 COMMISSIONER LEMAN: Perhaps we can come back
22 for a moment to the 12 per cent investment tax. You have
23 described it here, and you say it was a levy of 12 per
24 cent on capital expenditures above a certain minimum.
25 Was it applied without any administrative system? Was
26 it absolutely automatic? Suppose a company had already
27 embarked on a certain expansion program when this came
28 into effect? Did the 12 per cent automatically apply,
29 or could they get exemption by proving that their
30 project was something that was already commenced?



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COMMISSIONER LERMAN: Perhaps we can come back for a moment to the 12 per cent investment tax. You have described it here, and you say it was a levy of 12 per cent on capital expenditures above a certain minimum. Was it applied without any administrative systems? Was it absolutely automatic? Suppose a company had almost into effect? Did the 12 per cent automatically apply, or could they get exemption by proving that their project was something that was already commenced?



1 PROFESSOR LUNDBERG: No, it was applied
2 on the expenditure during the year, but, you know,
3 managers are usually very skilfull in getting around
4 problems of this kind, and all kinds of allowable
5 tricks were used by corporations in seeing to it that
6 deliveries of machinery were accelerated or that they
7 were postponed a little, and in this way they certainly
8 avoided part of the tax. Things like that must happen.
9 It is not good, of course, from the point of view of
10 applying such a heavy tax when people can avoid it
11 by post-dating or ante-dating things.

12 In the main, if you look away from such
13 bad features of the tax, it did apply with great
14 heaviness upon corporations, and forced them to postpone
15 as much as possible of investment expenditures during
16 that time. I agree that it has some of the bad
17 features that you refer to. I think the general
18 view is that this kind of measure should be applied
19 only during times of extreme difficulty in managing
20 a boom period.

21 We know that the investment reserve policy
22 is not very good in dampening a boom. It is good
23 in making managers and entrepreneurs make the invest-
24 ments during a recession, but putting investment
25 reserves into the Riksbank is not a very effective
26 method in dampening capital expenditures during a boom,
27 in my opinion. An investment tax is much more effective
28 from that point of view.

29 We had a special supplementary device during
30 1960-61 by which we used this investment fund technique



PROFESSION NUMBER: No, it was applied

managers are usually very skillful in getting around problems of this kind, and all kinds of allowable tricks were used by corporations in seeing to it that deliveries of machinery were accelerated so that they were postponed a little, and in this way they certainly avoided part of the tax. Things like that must happen. It is not good, of course, from the point of view of applying such a heavy tax when people can avoid it by post-dating or ante-dating things.

In the main, if you look away from such had features of the tax, it did apply with great heaviness upon corporations, and forced them to postpone as much as possible of investment expenditures during that time. I agree that it has some of the bad features that you refer to. I think the general view is that this kind of measure should be applied only during times of extreme difficulty in managing a boom period.

We know that the investment reserve policy is not very good in dampening a boom. It is good in making managers and entrepreneurs make the investment during a recession, but putting investment reserves into the Reserve Bank is not a very effective method in dampening capital expenditures during a boom, in my opinion. An investment tax is much more effective from that point of view.

We had a special supplementary device during 1960-61 by which we used this investment fund technique



1 for mopping up surplus liquidity in the economy. That
2 was a special feature that applied to this problem that
3 was not thought of before, but that just complemented
4 the measures that were applied during that period. It
5 was rather simple to make all entrepreneurs, instead
6 of paying in 46 per cent of the investment reserve
7 that they allocated out of profits to stimulate them to
8 put 100 per cent of their reserves into the Riksbank
9 which paid them well for doing it. They were paid so
10 well by means of extra allowances that the yield was
11 about 9 or 10 per cent. They took the money out of the
12 the commercial banks and deposited it in the Riksbank,
13 and that was an open and regular operation which yielded
14 a very high rate of interest.

15 COMMISSIONER LEMAN: What was the method of
16 paying them so well?

17 PROFESSOR LUNDBERG: It was by this means that
18 I mention on page 13 -- this 10 per cent deduction from
19 taxable profits. It was calculated on what you paid
20 into the Riksbank above what you would otherwise pay
21 in taxes. That was applied so generously that, in fact,
22 the yield on the money you paid into the Riksbank
23 amounted to something approaching 10 per cent. I think
24 it was a too expensive way of getting that done, and it
25 also meant that the banks were suddenly squeezed out of
26 funds that had been deposited by the corporations in
27 previous years which had come from the budget deficits
28 that had been financed by the commercial banks.

29 The bank by which I am employed as economic
30 adviser had many large customers in industry who found



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COMMISSIONER LERMAN: What was the method of paying them so well?

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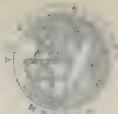


1 that it was better to have the money in the Riksbank
2 under this condition than in our bank. The Scandinaviska
3 Banken was quickly put into a position of squeeze by this
4 flow of funds into the Riksbank.

5 That shows the power of imagination on the
6 part of the authorities in applying a combination of
7 fiscal and monetary policy. I do not know whether
8 it is monetary policy or fiscal policy, but the name does
9 not matter. Anyhow, it was a very quick way of
10 eliminating and mopping up surplus liquidity, and in a
11 way I consider it a little more elegant than the method
12 applied during 1955-57 when liquidity ratios and credit
13 ceilings were applied, and when there was a ceiling
14 on the bank's advances. This was a more elegant or
15 more orthodox way of doing it, although a more expensive
16 one.

17 THE CHAIRMAN: We shall adjourn for a few
18 minutes.

19 ---A short recess.
20
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that it was better to have the money in the Riksbank
under this condition than in our bank. The Scandinavian
Banken was quickly put into a position of squeeze by this
flow of funds into the Riksbank.
That shows the power of suggestion on the
part of the authorities in applying a combination of
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it is monetary policy or fiscal policy, but the name does
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1 COMMISSIONER MACKINTOSH: Professor
2 Lundberg, the matters we have been talking about
3 undoubtedly contributed to a very helpful fiscal
4 policy to go with your monetary policy. Were there
5 any other elements in the fiscal policy of the
6 government which you found particularly helpful in
7 recent years?

8 PROFESSOR LUNDBERG: There were both
9 unhelpful and helpful elements. That is the same
10 in all countries. Part of our troubles are caused
11 through what we call stabilization policies creating
12 instabilities. There are theories and views on
13 the general economic development in Western Europe
14 during the post-war period, maintaining that those
15 instabilities we have had are very much the effects of
16 governments trying to create stability. That is
17 an old theory, that presumed it was the bad monetary
18 policy carried out, with increases of rate of interest
19 at the last stage of the boom, contributing much
20 to the crisis that came about. If in a recession
21 you apply, as we have been applying, a very expansionary
22 fiscal policy, creating a big budgetary deficit,
23 having expanding public works and filling the banks
24 with money, as a result of this fiscal policy you
25 create trouble for the next boom period. You
26 create difficulties for yourself in managing the
27 boom that follows because of the liquidity created.
28 When you try to really manage the boom,
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Lundberg, the matters we have been talking about undoubtedly contributed to a very helpful fiscal policy to go with your monetary policy. Were there any other elements in the fiscal policy of the Government which you found particularly helpful in

stabilizing the economy?

PROFESSOR LUNDBERG: There were both

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1 fiscal policies or having effective built-in stabilizers
2 at work, with the high progressive taxes, as we have
3 in Sweden, that helps to stabilize the boom. Our
4 economies are so integrated with each other's
5 that it is very difficult to say to what extent
6 the policies carried out are stabilizing or un-
7 stabilizing.

8 We think that the kind of fiscal
9 policy we had during the years from the middle of
10 the fifties was rather bad, creating problems.
11 The steady government deficit created during the
12 recession periods was making the monetary policy
13 more difficult than it otherwise would have been.
14 So, the fiscal policy had not been so well co-
15 ordinated with monetary policy, as would have been
16 desired.

17 On the other hand, I must say, of course,
18 that the expansion of government expenditure during
19 the recessions has helped to counteract the
20 recessions. Also, some restriction of government
21 expenditure during the boom period has also helped;
22 but, in the main, I think that government fiscal
23 policy has not been so effective, except for the
24 investment tax up to the last few years.

25 But from 1960, with the introduction of
26 the general sales tax, the government finances have
27 come in order. The government has reached a
28 situation of over-balancing the total budget for
29 the first time in many years. That has given more
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possibilities of managing also monetary policies. So I would say that the kind of general sales tax introduced from the beginning of 1960, and increased from the beginning of 1962, has been helpful in preventing the creation of liquidity and also in keeping down private consumption expenditure to a certain extent. There will be greater possibilities of having a coordination between monetary and fiscal policies by the government when the budget is brought into better balance in this way.

Another aspect of fiscal policy which I mentioned in my memo, and which I would like to mention now, is the introduction of the general pensions scheme which has changed the environment of monetary policy quite a lot. It is really a very ambitious kind of scheme. I disregard here the welfare element in the pensions system as such, for individuals, and look upon its financial aspect.

From this point of view the intention of combining a big pension reform with a big pension savings fund was that when you take away the incentive of saving to the private individual that is combined with looking at old age, and having private insurance taking care of the kind of building up of reserves that is necessarily combined when you arrange your pension in that way -- when taking that incentive away and introducing a general government scheme of generous insurance for the whole population, we were



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1 afraid the system would fall down very much, and that
2 insurance companies would have bad effects on savings.
3 Therefore, the pensions reform was combined with
4 the building up of a big pension fund. That is not
5 at all necessary technically for arranging the
6 pension reform. You can always take up premium
7 payments high enough to cover the yearly expenses.
8 But to balance the effect of falling away of private
9 savings that pension fund was created.

10 I was a member of a committee under
11 the chairmanship of the governor of the Riksbank to
12 find ways and means and techniques of managing
13 such a fund in order to make as little a disturbance
14 in the working of our imperfect financial system
15 as possible. We were afraid this fund would get
16 such a tremendous grip over our capital market that
17 it would be dangerous.

18 COMMISSIONER MACKINTOSH: Is the whole
19 of the pension liability funded?

20 PROFESSOR LUNDBERG: No, just an
21 arbitrary part of it. It has no actuarial
22 thinking behind it at all. It is just the part
23 we thought sufficient for compensating potential
24 loss in savings.

25 The order of size of the pension fund
26 I could indicate by transforming it into Canadian
27 conditions, and putting it into the comparative
28 size of your Gross National Product in relation
29 to our Gross National Product. At the end of
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26 will depend on the conditions, and putting it into the comparative
27 size of your Gross National Product in relation
28 to our Gross National Product. At the end of



1 this decade the size of this pension fund will be
2 about \$15 billion (Canadian) that is related to
3 your conditions. The yearly increase is
4 so heavy that it really matters very much in the
5 regular contributions to long term savings of the
6 country.

7 Then, of course, it is a problem for
8 a country of our size to manage this and not give
9 the man in control of this fund too much power and
10 influence over the whole economy. The technique
11 employed was partly one of dividing into three
12 funds, depending on the sources from which the
13 premiums came. The other is that of having
14 industrial corporations being given the right to
15 borrow back part of the premiums they pay into
16 the pension scheme on the wages that they pay out.
17 So that now it is arranged so that every
18 corporation paying pension premiums for their
19 workers into the fund has the right to borrow
20 back half of this for their own use at the market
21 rate of interest. That is a way of decentralizing
22 the effect of concentrating so much power in the
23 fund. However, the private corporations have
24 not been using this possibility to any great
25 extent, but during credit squeezes they will be
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1 This way of dividing the fund into three
2 parts has not worked out, because the whole technique
3 of administering the funds is carried out by one
4 manager and three employed people. It is an
5 "easy" job, taking out sums of money and placing
6 the money into security. They are not to do
7 direct lending business, buying shares and stocks.
8 They just place the money into government and industrial
9 bonds, and long term obligations of that kind, and
10 nothing else, except for re-lending to industry
11 paying premiums.

12 The man doing this job is a very responsible
13 person, and will have a lot to say about the kinds
14 of yields that he will accept as satisfactory from
15 the point of view of the Swedish pension takers
16 in the future. We should include this in the
17 fiscal policy measures in a very broad sense, it is
18 part of it, because this means that we have a new
19 supply coming in regularly, and a reliable one, on
20 the long term market for bonds. That has
21 shifted and changed our whole financial climate
22 in Sweden rather drastically from the end of the
23 fifties to the beginning of the sixties.

24 The combination of what I said about
25 the finance minister being able to balance the budget
26 by the new tax on consumption expenditure -- combined
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29 capital funds has declined, because the government
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1 has not the deficit any more and at the same time
2 that the supply has increased. The increase of
3 the funds of the private insurance companies has not
4 grown as rapidly as before, but surprisingly much,
5 with the net result that there is a heavy increase
6 in the supply of long-term funds for the Swedish
7 economy. So, on the capital budget side there
8 is a much better balance than we have ever had
9 in the post-war period. This means it will be
10 easier to carry on the monetary policy under these
11 better balanced positions.

12 COMMISSIONER MACKINTOSH: All this
13 has as a background your very satisfactory growth
14 rate during this period. With a less satisfactory
15 growth rate would you favour being pretty bold
16 in deficit financing in the expansion of government
17 expenditures, which you implied have been overdone
18 in Sweden, in your circumstances?

19 PROFESSOR LUNDBERG: During the
20 fifties?

21 COMMISSIONER MACKINTOSH: Yes.

22 PROFESSOR LUNDBERG: I would say it
23 was a bad fiscal policy and before the growth of
24 the Swedish economy we, most of the time, because
25 of this, had excess demand for commodities and
26 labour, and the difficulty created by surplus
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the Swedish economy we, most of the time, because
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1 You get some kinds of inefficiency
2 out of the excess demand which we had during these
3 periods. When entrepreneurs and corporations
4 have excess demand for their products and workers
5 have a very strong position in the firms, they
6 all act in a relatively ineffective way. There
7 must be a certain amount of pressure in order to
8 make people manage their jobs with efficiency.
9 We have had over-mobility of labour. You know
10 you can have over-mobility of labour as well as
11 too little mobility, and during those periods
12 people were just leaving one job for another when
13 they considered it better, and that created
14 difficulties for management. Management had
15 not the pressure on them of keeping down costs,
16 under those inflated conditions in which the
17 Swedish economy worked during part of this period.
18 Now that had much to do with fiscal policy
19 that was too expansive, from this point of
20 view.

21 I think that after 1957, anyhow, as
22 far as we can see, productivity has been increasing
23 more rapidly than during the times before, and
24 that has something to do with harder competition
25 in the world markets, and also more competition
26 on the Swedish market and less of excess demand.

27 But as I have put it in my memo, we
28 are aware of the fact that very much of the increase
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1 of productivity in any country refers to the fact
2 that you must shift resources all the time from
3 stagnating branches of activity to the expanding
4 ones. In order to do that you can get too much
5 of excess demand, so even those sectors of the
6 economy which should lose manpower have good times
7 and the others have over-good times, and you get
8 bad results. On the other hand, you can have
9 such sluggish and low demand that even growth
10 industries have difficulties so that they will not
11 grow and, therefore, you have unemployment and
12 sagging in the stagnating industries. There
13 is an optimum in between where you have a certain
14 amount of excess demand in growth industries, that
15 you hope to satisfy by shifting your resources
16 from the stagnating to the growing industries.
17 That is what we hope to fulfil.

18 We know that the times to come will be
19 more difficult, perhaps, than the times past,
20 because the shifts of the European markets and
21 over-capacity problems coming up mean that
22 management and industry have to be aware of shifts
23 in resource application more than perhaps during
24 the fifties, and that puts great claims on a
25 sensible economic policy.

26 COMMISSIONER MACKINTOSH: But you would,
27 in periods of slack demand, favour deficit
28 financing?
29
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1 PROFESSOR LUNDBERG: Yes, I have not much
2 of inhibitions in that direction. There are limits
3 even there, however. You might put so much money
4 in circulation or have such excess demand that you
5 create dis-confidence, and people will react badly.
6 How they react depends very much on what they are
7 accustomed to. Certain people react strongly to
8 any kind of government deficit financing and
9 pronounce dis-confidence in the fiscal policy
10 and have such powerful positions that difficulties
11 in carrying on an expansive policy will be
12 created.

13 However, in Sweden we have not that kind
14 of situation, really, so I think that when we meet
15 the next recession, and especially after having
16 had a time of government surpluses and orderly
17 financing, it will be easier for the finance minister
18 quickly to lower taxes or expand government
19 expenditure, and thus enjoy the deficit as a
20 stimulation to the economy, knowing it is just
21 for the time being, without creating trouble. That
22 is accepted as a policy measure.

23 Of course, as I have made reservations
24 before, we might also experience troubles with
25 an exchange crisis. So far I have not been able
26 to explain to you why we have not had troubles.
27 However, if I have an opportunity to come back
28 here in ten years' time we might have "enjoyed",
29 in the meantime, an exchange crisis that I may
30 be able to explain, and therefore would be able to



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1 throw more light on this question than I am able
2 to do now. But we are quite open to the possibility
3 that our expansive policy might be more limited just
4 because of exchange difficulties in a future recession.

5 COMMISSIONER MACKINTOSH: I think this
6 means the Swedes are not more inventive than
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Committee
on Finance

1934 -

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1 PROFESSOR LUNDBERG: We have had lots
2 of good luck. I think we have "chosen" a better
3 structure for our economy than you have from this
4 point of view. As I have said in this memorandum,
5 we have not tried to protect all our industries,
6 putting high tariffs on and getting secondary
7 industries in all fields, but instead, letting the
8 development occur under hard competition and letting
9 the most enterprising and expanding firms work and
10 fight on their own markets with competitors from
11 abroad and squeezing the inefficient out of business.
12 I think that explains why we have had greater
13 possibility of fighting and not getting into troubles
14 along those lines.

15 COMMISSIONER BROWN: On the pension
16 scheme, did I understand you to say in your evidence
17 when you were discussing it this morning that there
18 was some method of compensating for the cost of
19 living increase?

20 PROFESSOR LUNDBERG: Yes.

21 COMMISSIONER BROWN: Could you describe that
22 to us?

23 PROFESSOR LUNDBERG: Yes. It is very
24 simple: the people now paying pension premiums have
25 been promised pensions in future related in the real
26 value terms. There is a consumption price index
27 accepted as good evaluation of what the costs of
28 living are and will be, and the pensions being paid
29 out will not be paid out according to actual
30 premiums and nominal values paid in now, but according



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1 to the actual value of the money when they get the
2 pensions. So, they pay and are promised pensions
3 relating to the future level of wages for the living
4 population at that time. It is a guarantee as to
5 the standard of life in relation to the living
6 population at that time. The philosophy behind
7 this is simply that those people working now for
8 the future of the Swedish economy are really
9 investing and working and saving for the living
10 generations that will support them in the future.
11 They have done the job that makes the future standard
12 of living what it will be when they are pensioners,
13 and they should have a part of that standard of
14 life. So, it is a very generous kind of scheme
15 from that point of view. Looking backward I think
16 the old system was a kind of cheating. When people
17 had paid premiums from before the first World War
18 and are getting nominal values according to the
19 premiums paid at that time, that is really bad from
20 equity point of view. However, the Swedish
21 scheme might mean troubles also. It will mean as our
22 population is aging that it will be a heavy burden
23 on the future generation.

24 COMMISSIONER BROWN: Is this a pension that
25 comes as a right or only to those who have contributed
26 to it?

27 PROFESSOR LUNDBERG: There are lots of
28 complicated transfer difficulties. With those
29 people now paying who are over 50 years of age, they
30 will not get the full pension, but they will get more in



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relating to the future level of wages for the living
population at that time. It is a guarantee as to
the standard of life in relation to the living
population at that time. The philosophy behind
this is simply that those people working now for
the future of the Swedish economy are really
investing and working and saving for the living
generations that will support them in the future.
They have done the job that makes the future standard
of living what it will be when they are pensioners,
and they should have a part of that standard of
life. So, it is a very generous kind of scheme
from that point of view. Looking backward I think
the old system was a kind of cheating. When people
had paid premiums from before the first World War
and are getting nominal values according to the
premiums paid at that time, that is really bad from
an equity point of view. However, the Swedish
scheme might mean troubles also. It will mean an over-
population is aging that it will be a heavy burden
on the future generation.

COMMISSIONER BROWN: Is this a pension that
comes as a right or only to those who have contributed
to it?

PROFESSOR LUNDBERG: There are lots of
people now paying who are over 50 years of age, they
will not get the full pension, but they will get more



1 relation to what they pay in premiums. They are over-
2 compensated in relation to the premiums they have paid,
3 but they will not get the pensions in relation to the
4 people who will have been paying for 30 years. Every
5 person in Sweden now is collecting pension points, and
6 pension points are related to what kind of wages they
7 have on a certain basis up to the amount of 30,000
8 crowns (in 1960 value of money) -- a little less than
9 a professor's wage. So that, the pensions will be
10 graduated in relation to the wages and salaries that
11 people have been earning during their working time,
12 up to a certain limit. There are possibilities for
13 people in the higher wage groups who have pension
14 arrangements to complement and add to their general
15 pensions by private insurance companies, as usual,
16 but that is outside this scheme. It has been the
17 argument among the labour population in Sweden --
18 the socialists and trade union people -- that our
19 society is a class society still, not in the least
20 from the point of view that salaried people and
21 people with higher wages had better payments and
22 sickness allowances and pension rights, and the workers
23 were very poorly endowed in that regard. Now, with
24 this pension reform, they are very much in the same
25 positions as the white collar workers; they have about
26 the same pension rights as the salaried workers --
27 corresponding to about 60 per cent of wages during
28 active life. That is a good standard of living and I
29 think it is too ambitious, because the current
30 cost of keeping alive when you are old, not having all

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1 family responsibilities, is much lower. It has been
2 a heavy competitive pressure between political parties
3 to take care of these possibilities. It is not
4 only the socialists' fault that the reform has become
5 very generous. The other parties have been as active
6 in that regard in order to earn votes.

7 COMMISSIONER BROWN: This seems to be a
8 world-wide phenomenon.

9 PROFESSOR LUNDBERG: Yes. The important
10 side of this scheme is that it means that it is much
11 easier for entrepreneurs to take on old workers and
12 old salaried people without the heavy cost of their
13 pensions when they take them. So, it also helps for
14 mobility of labour. The pension right is
15 independent of where you work -- this right of
16 earning pension points. It follows you through life.

17 COMMISSIONER MACKINTOSH: I would like to ask
18 you one or two things on a matter that you have already
19 spoken of to some degree. To what extent is there need
20 for in the Swedish economy a wages policy? How do you
21 cope with the bargaining position of the workers and
22 the increase in wages which is apt to result?

23 PROFESSOR LUNDBERG: It is a very great
24 difference from the Dutch position, as you discussed,
25 I think, yesterday, where they have a central board
26 with some very strong powers, potentially, to regulate
27 and determine the policy of the country. The
28 Australians have compulsory arbitration and courts of
29 that nature. We have nothing of that kind. Both the
30 employers' unions and the trade unions fight against any



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1 government interference into the wage determination of
2 the country. They like to keep to their own ways of
3 determining their wages and feel that the labour market
4 should be free from government interference. There is
5 a very strong belief in this from the trade union side
6 as well as from the employers' side. They are
7 completely united in this respect.

8 Our finance ministers have many times taken
9 up the problem with the trade union leadership and
10 said, "Now, you should be restrictive and not carry
11 on that kind of wage policy and demand too much and
12 too high wage increases in this situation. You are
13 making it still more difficult for me as finance
14 minister to carry out my duties in regulating the
15 economy and trying to avoid inflation." The trade
16 union leader has always answered, "It is not our job
17 to concern ourselves with the value of money. That
18 is your job as finance minister. We cannot in
19 relation to our workers say that we have abstained
20 from using the wage increase possibilities when the
21 entrepreneurs have been willing to pay us more because
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1 "We would be dismissed by our workers,
2 and great dissatisfaction would arise if we took
3 on the burden and the job of demanding less
4 wage increases than we know can obtain out of the
5 entrepreneurs' profits. So, please don't ask us
6 this." So they say to the finance minister
7 and the head of the Riksbank, "You must carry
8 out your policies so that there will be no excess
9 demand for labour, so that the entrepreneurs are
10 not offering us too high wages and tempting us.
11 It is your job to do this and we will see to it
12 that the general wage level will be adapted to the
13 kind of situation you are creating by the policy
14 and that big wage differentials do not develop."

15 It was a different situation in 1951-
16 1952 when the responsible trade union people
17 demanded 20 per cent. They said, "The entrepreneurs
18 are willing to pay, and you carry on a reckless
19 finance policy so that we have to demand these
20 wages. We are sorry for you, but what can we do
21 about it?"

22 From this point of view, you might say
23 that this is no wage policy at all, but I maintain
24 that it is in a way. Our trade union leadership
25 is very centralized. We do not have at all that
26 kind of English, American or Canadian rivalry
27 between the trade unions, and that makes the thing
28 much easier. For the white collar workers the
29 trade union is also centralized and very strong. They
30 carry on wage negotiations for the coming year starting



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1 in November and concluding in about March. They make
2 something like a central wage directive to the different
3 trade unions all over the country, and they try to
4 find out what the employers will pay, what the workers
5 are demanding, and what the pressures are, and they
6 fill all this out with a tremendous amount of
7 negotiation and research. From this comes a general
8 crystallization of 4 per cent of 5 per cent general
9 wage increase with some kind of differential according
10 to the different branches of activity that seems
11 reasonable in order to repair some unacceptable
12 differentials that have appeared in the last few years.
13 When the trade unions work out the differentials in
14 the factories they follow the central recommendations
15 very closely.

16 All this means there is not a wage policy
17 from the Dutch point of view at all. It is a market
18 policy where the trade unions and employers' unions
19 fight very vigorously with the menace of lockouts
20 and strikes in the background. However, we have
21 not had a strike since 1945 of any considerable size.
22 There have been very few hours lost -- some few,
23 but very little of it.

24 We have a labour court which is very effective
25 in seeing to it that no collective agreements break
26 down during the time of the agreement. That never
27 happens in Sweden, because of the acceptance of the
28 judgment of the court. There must, of course, be
29 some menace of something in the background such as a
30 lockout or a general strike. So that the policy is



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1 that the employers' unions and trade unions try to
2 work out what is tolerable and what is acceptable.
3 The policy means that they try to adjust wage changes
4 according to the developments in the different sectors
5 of the economy. They would see to it that the
6 entrepreneurs in a particular activity, whether it
7 is one with low profits and no active trade, that there
8 will be lower wages or keep down the wage increases
9 too much. There may be a certain tolerance, but not
10 too much, and that will be quickly taken back
11 another year.

12 It is, as I have said, a central wage
13 policy from the point of view that it is big
14 organizations to bargain and fight out the general
15 development of wages, but it is not a government
16 policy. They can only indirectly influence the
17 situation by the type of economic situation, and
18 demand for goods and labour that is created by
19 policy.

20 The difficulty with this kind of wage
21 policy is that we have so much piece rate wages,
22 and this means when new machines are introduced,
23 new deals and wage bargaining always continuously
24 happen. There is the wage slide when there is a
25 high demand for labour. So, if you look at it in the
26 general development of Swedish wages, you will find
27 half of the wage increases over time are explained
28 by what we call wage slides; that is, outside
29 collective agreements. These wage slides will be
30 determined and will fluctuate over the business cycle,



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1 so that if there are boom times wage slides will be
2 higher, and much lower during recessionary times. Each year
3 or each second year when there are general collective
4 bargainings account will be taken of what has happened
5 on the wage front with these slides so that unjust
6 differentials can be removed. I do not know if I can
7 make myself clear. Books have been written about
8 this, and I cannot explain all this in just a short
9 speech.

10 COMMISSIONER MACKINTOSH: That is very clear.
11 I gather from what you said earlier that an essential
12 element in this process is a pretty strong and pretty
13 sophisticated bureaucracy in the labour movement so
14 that they are extremely well informed?

15 PROFESSOR LUNDBERG: One interesting
16 feature of the trade union movement is that they like
17 private enterprise. They don't like socialist and
18 government enterprise because it is no fun to fight
19 them. It is very easy to be government controlled
20 if it is a government enterprise. The union people
21 are very strong in holding on to a very big private
22 sector in the economy to enjoy this fight with private
23 entrepreneurs and squeeze profits out of them. You
24 will notice among trade union people that their
25 attitudes are very strong for free trade, free
26 enterprise, free collective bargainings, and mobility
27 of labour, and they are very strong advocates of
28 competition from abroad. Also, a strong hold for
29 private enterprise in Sweden is taken by our co-
30 operative societies; they play a very great role in



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28 competition from abroad. Also, a strong hold for
29 private enterprise in Sweden is taken by our co-
30 operative societies; they play a very great role in



1 Sweden. A large sector of retail trade and also a
2 large sector of production is carried on by a very
3 big co-operative control movement. Although many
4 of the leaders are socialist and trade union leaders,
5 they also "love" private enterprise because they like
6 to compete with them. They like to show they are more
7 effective, and they are very strong pleaders for
8 avoiding measures that would put difficulties in the
9 working of competition in the Swedish economy. The
10 private people, especially in retail, often do not
11 understand what a strong defence for private
12 enterprise these co-operative movements, as well as the
13 trade unions, really are against people who would
14 like to go on with more interfering and more
15 socialistic measures than our socialistic government
16 is actually carrying out.

17 THE CHAIRMAN: I wish to thank you very
18 much indeed, Professor Lundberg. We have had a
19 most interesting day. Your comments and the
20 information that you have provided have been very
21 helpful to our deliberations.

22 PROFESSOR LUNDBERG: Thank you. I have
23 enjoyed these sittings very much, and I hope I have
24 succeeded in making myself understood.

25 THE CHAIRMAN: We will adjourn now until
26 9:15 tomorrow morning.

27 ---Adjournment.
28
29
30



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Royal Commission on Banking and Finance

MR. ERIK LUNDBERG

Hearings
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MEMORANDUM FROM MR. ERIK LUNDBERG

TO THE

ROYAL COMMISSION ON BANKING AND FINANCE

RE

PROBLEMS OF STABILIZATION
POLICY IN SWEDEN AND CANADA

Stockholm,
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PROBLEMS OF STABILIZATION POLICY IN SWEDEN AND CANADA

In this memorandum I have tried to give an account of stabilization policy experiences in Sweden during the last decade that might be of interest from Canadian viewpoints. In order to avoid the danger of easy generalizations from Swedish experiences, I have presented a short account of some similarities and differences between Canadian and Swedish economic structure and economic problems. It is clear to me that much of the political milieu, the financial structure, the credit institutions a.s.o. are so different between Canada and Sweden that no easy and mechanical transfer of knowledge can be made. On the other hand also, the differences in attitudes and methods of approach may be stimulating for a discussion of policy problems. I hope that it is clear from the text that I am quite critical of various parts of Swedish economic policy, although I naturally try to put special emphasis on the policy achievements in Sweden that seem most interesting from a positive point of view. My very tentative recommendations as to the approach to some Canadian stabilization problems are made in a humble consciousness of well-balanced ignorance of political economies in Canada. They are just put down as a reaction to the Canadian problems from the point of view of the policy attitudes in Sweden and are presented here in order to give emphasis to important differences in both policy problems and policy attitudes.

1. Some similarities and differences in Economic Structure.

When comparing Canada and Sweden, there are



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When comparing Canada and Sweden, there are



1 certain common features of economic structure and
2 similarities as to policy problems. From this point
3 of view, it is of interest to compare the growth and
4 stability experiences of the two economies. There are,
5 however, at the same time, interesting dissimilarities
6 in the experiences of the two countries from which some
7 useful knowledge may also be extracted.

8 Let me first mention some common features as
9 to economic structure: We have in the main to do with
10 free enterprise economies - referring to industry,
11 trade, agriculture, banking and the rest of the
12 financial system. Both countries have relatively
13 high national income per capita and high dependence on
14 foreign trade (exports being around 20 per cent of
15 gross national income). Exports depend in both
16 countries to a large extent on internal raw material
17 resources (from mines and forests). Both countries
18 are highly industrialized. The gross investment ratios
19 are of the same order, of size although higher in
20 Canada up to the middle of 1950's; around 1960
21 Sweden seems to have the higher ratio. There are
22 relatively large Government sectors in the two
23 countries. Both countries have similar positions
24 vis à vis "super-neighbours" in the South (USA and
25 EEC respectively) as most important trading partners.

26 There are also fundamental similarities as
27 to targets of economic policy: Full employment,
28 stability of the price level, equilibrium in balance
29 of payments, stable and rapid economic growth. Also,
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1 with reliance on a mixture of monetary and fiscal
2 policies for reaching the stabilization targets.

3
4 Let me now mention some dissimilarities.

5 Canada is relying on a considerable amount of capital
6 imports from USA. Sweden has not had sustained long-
7 term capital imports since before the first World War
8 and had even sizable capital export during the inter-
9 war period. During the post-war period, long-term
10 capital imports and exports have played no role in
11 Swedish economic development. This means that the
12 gross savings in relation to national income coming
13 from internal sources seem to have been higher in
14 Sweden. Sweden, therefore, misses the type of
15 complication in policy problems that arises out of
16 high dependence on capital imports from a dominating
17 power like USA.

18 Sweden's exports have a more happy
19 composition (from a stabilization and growth point
20 of view) than Canada's. The raw material component
21 of iron ore, wood products and agricultural products
22 is lower. Instead, in Swedish exports, such products
23 as high quality steel, ships and especially engineering
24 products take a large and rapidly growing part. The
25 result is also that Sweden's export volume has been
26 increasing nearly three times as rapidly in relation
27 to real GNP as Canada's.

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1 lowest. Also, because of a much higher rate of
2 immigration, the Canadian labour force has been
3 increasing much more rapidly than the employed
4 population in Sweden.

5
6 Canada is a relatively protectionist country;
7 Sweden has about the lowest tariffs of all countries
8 in the world. Here there is an important difference
9 in attitudes determined by historic traditions, economic
10 structure and development conditions. The Swedish
11 outlook is determined by a strong general belief in
12 vigorous foreign competition as a necessary condition
13 for efficiency in industry as well as for effective
14 price competition. This attitude is, (as a principle),
15 common to both labour and employer groups. There is no
16 belief in labour (or socialist) circles that socialized
17 corporations under planning work more effectively than
18 private industry under competition. It is hardly
19 necessary to mention the more fundamental difference
20 that Sweden geographically is a very small country in
21 relation to Canada (about 5 per cent of the surface
22 area). This creates a difference in handling regional
23 problems. In Sweden, an active labour market policy
24 is one of the new important parts of economic policy
25 and this implies, among other things, various measures
26 to create higher labour mobility between jobs, branches
27 of activity and regions of the country. It must be
28 easier to create a satisfactory regional mobility in
29 a country like Sweden than in Canada.
30



lowest. Also, because of a much higher rate of immigration, the Canadian labour force has been increasing much more rapidly than the employed population in Sweden.

Canada is a relatively protectionist country; Sweden has about the lowest tariffs of all countries in the world. Here there is an important difference in attitudes determined by historic traditions, economic structure and development conditions. The Swedish outlook is determined by a strong general belief in vigorous foreign competition as a necessary condition for efficiency in industry as well as for effective price competition. This attitude is, (as a principle), common to both labour and employer groups. There is no belief in labour (or socialist) circles that socialized corporations under planning work more effectively than private industry under competition. It is hardly necessary to mention the more fundamental difference that Sweden geographically is a very small country in relation to Canada (about 5 per cent of the surface area). This creates a difference in handling regional problems. In Sweden, an active labour market policy is one of the new important parts of economic policy and this implies, among other things, various measures to create higher labour mobility between jobs, provinces of activity and regions of the country. It must be easier to create a satisfactory regional mobility in a country like Sweden than in Canada.



1 2. Economic policy problems.

2 Although the main targets are the same, the
3 policy problems have a different accent in the two
4 countries, partly because of varying kinds and degrees
5 of deviation from the goals. Sweden has had more
6 trouble with inflation than Canada, the rise in the
7 cost of living index being in average about 4 per cent
8 per year over the whole post-war period. The problem of
9 a too rapid increase of wage costs is a burning issue
10 in Sweden - not least from the point of view that Sweden
11 has a relatively high wage-cost level (in relation to
12 all Western Europe competitors). It is also apparent
13 that excess demand problems have been much more in focus
14 than in Canada.

15 On the other hand, Canada has had relatively
16 more trouble with the stability of growth than Sweden.
17 Sweden has had less of business cycle recessions of
18 production and employment than Canada - although Sweden
19 also had unemployment and stabilization problems in
20 1952-53 and 1958-59 that had to be taken seriously.
21 Sweden has had no experience of a longer stagnation
22 period, with none or very little growth of national
23 income per capita, as in Canada over the years 1957-61.
24 Sweden's economic process has been relatively stable over
25 the whole post-war period, with a somewhat lower rate
26 than Canada's; but on a per capita basis, Sweden seems
27 to have had a more rapid rate of growth. In fact, there
28 has been relatively little discussion in Sweden about
29 insufficient growth in comparison with other countries.
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1 The fact that real GNP has grown more slowly during
2 the post-war period in Sweden than in some other
3 countries in Western Europe (as Germany, France and
4 Italy) has been taken with great calm. The starting
5 level of the post-war expansion has been high in
6 Sweden (as well as in Canada and USA) compared with
7 most other European countries. If a longer-term
8 growth rate (reckoned for instance from the 1930's)
9 is considered, Sweden ranks with the highest among
10 comparable countries.

11 The balance of payments problems seem to have
12 been more disturbing in Canada than in Sweden. As
13 mentioned above, Canada's dependence on capital imports
14 and the composition of Canada's exports (with a slower
15 growth rate) must imply greater risks for exchange
16 disturbances. The rapidly expanding markets of
17 especially Swedish engineering products has implied
18 good "space for internal expansion" without narrow
19 balance of payments restrictions. Only in the year
20 1947 (after an appreciation of the Swedish Crown), did
21 the Swedish Government succeed in creating an exchange
22 crisis. In a way, it has been a continuing surprise
23 to many economists that since then - with rather
24 complete import liberalization and full convertibility
25 (except for capital movements) - the Swedish payments
26 position has been kept in equilibrium (with slowly
27 rising exchange reserves) in spite of heavy demand
28 pressure inside the country and an average rise of
29 wages per hour of about 7 per cent per year.
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2 above account of policy problems seems to imply that
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4 handle" than the Canadian ones. Efficiency of
5 stabilization policy must of course be measured with
6 regard to the difficulties involved, i.e., to the
7 potential deviations from the targets that tend to arise.

8
9 3. Differences in policy attitudes.

10 It is interesting to notice some rather
11 fundamental differences as to policy attitudes. The
12 Swedish Socialist Government has relatively few
13 inhibitions with regard to interference in financial
14 markets with its policy instruments. There is a pro-
15 pensity to experiment with new devices in order to keep
16 full employment or to dampen down an inflationary boom.
17 In Canada, there seems to be more of conservatism in
18 this regard. The Canadian Government seems to have
19 more with respect to the effective functioning of credit
20 and financial markets; these should, if possible, not
21 be disturbed with policy measures that could create
22 undesired anticipations. The Swedish Government and
23 Central Bank show rather little concern in this direction.

24 However, such a difference in attitudes as
25 discussed above is not general. In other respects
26 there may be contrary positions. I mentioned above the
27 attitudes to protection and foreign competition on the
28 home market. An important aspect of this issue is the
29 Swedish attitude to the functioning of the labour market.
30 Also, in this respect, there may be a difference from



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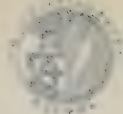
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1 the Canadian approach. In Sweden, the policy issue is
2 how to make the labour market function more effectively
3 along the pattern of a free market. High mobility of
4 labour between skills, jobs, branches of activity and
5 regions are taken as prerequisites of an effective
6 functioning. Effects in these directions are sought
7 by means of a system of well informed labour exchanges,
8 their activities including payments to workers for
9 moving and for training to new jobs. A Government
10 sponsored general pension scheme implies that there is no
11 extra cost in taking on older workers. Efficient
12 functioning of the labour market depends very much on
13 how close to equilibrium of demand and supply the
14 labour market is. Big excess or deficit demand conditions
15 will tend to cause bad use and allocation of labour
16 resources. A characteristic feature of the Swedish
17 labour market during the post-war period is a considerable
18 scarcity of workers (with many vacancies) within the
19 rapidly growing sectors of the economy. This situation
20 has implied relatively frictionless absorption of
21 unemployment coming from agriculture and textile
22 industry, so that the general unemployment rate has
23 never surpassed 4 per cent. A conscious wage policy
24 is also part of this scheme, aiming at economically
25 justified wage relations. This means for instance
26 that industries and firms with low productivity should
27 not be subsidized by having relatively cheap labour.
28 The underlying theory is that productivity-raising
29 changes in the structure of the Swedish economy will be
30 accelerated if labour, by being about as expensive as



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1 in the growth industries, is quickly squeezed out of
2 firms and branches with low efficiency and by means of
3 an active labour exchange policy, transferred to expand-
4 ing fields of activity. It is this type of philosophy
5 that is underlying the active labour market policy
6 carried out in Sweden, certainly with a considerable
7 lack of perfection in various respects. It is important
8 to remember this philosophy as a background when
9 discussing the monetary and fiscal stabilization
10 measures applied during the post-war period.

11 4. Policy instruments used in Sweden.

12 It may be convenient at this point to describe
13 the main monetary and fiscal policy instruments applied
14 during the last ten years in Sweden. It is natural
15 to start with policies carried out in order to dampen
16 excess demand (inflationary boom) conditions that
17 Sweden experienced during the periods 1955-57 and 1960-61.
18 In both cases, one of the main difficulties of restrictive
19 policy came from the fact that large budget deficits had
20 created excess liquidity in the private sector and
21 especially within the banking system. There was,
22 however, a fundamental difference between the two periods
23 in the method of dealing with the inflationary forces
24 emanating from excess liquidity. In the first period,
25 the main approach was to neutralize the liquid funds
26 that flowed to the banking system and to the corporations
27 as a result of financing large Government budget deficits
28 by monetary expansion. During the second boom period,
29 the monetary authorities aimed instead at absorbing and
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1 mopping up the surplus liquidity that had been created.

2
3 A combination of monetary and fiscal policy
4 measures were tried out from the beginning of 1955,
5 when a pronounced investment boom was on the way in
6 the private sector of the economy. An investment tax
7 was introduced from the beginning of the year. A levy
8 of 12 per cent on actual expenditures (above a certain
9 minimum) for machinery and building (not dwellings)
10 had to be paid. This type of measure had been used
11 temporarily at earlier occasions. The important point
12 was that this extra investment cost should not be
13 regarded as being of permanent nature. In that case,
14 there was apparently a great risk that the investment
15 tax would behave as an extra cost-push factor and thereby
16 be built into the price system. In actual fact, the tax
17 seems to have had a strong postponement effect, stimulat-
18 ing corporations to wait whenever possible with their
19 less urgent investment expenditures.

20 The level of interest rates was increased by
21 about 1 per cent in the spring of 1955 at the same time
22 as the requirements on liquidity ratios of the banks
23 were raised. These measures were enforced by regulating
24 bank advances, prescribing certain ceilings. This type
25 of credit regulations was complemented by a more permanent
26 Central Bank control of bond issues - referring to
27 communes as well as private corporations. All these
28 measures evidently implied severe regulations of the
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1 directed towards the commercial banks but the measures
2 were complemented by looser agreements with savings
3 banks and insurance companies with regard to their
4 investment policies.

5
6 One typical Swedish feature of this regulation
7 of the credit markets is that the liquidity requirements
8 and ceilings on advances were founded on "voluntary"
9 agreements between the Central Bank and the financial
10 institutions. As a necessary background condition for
11 reaching such agreements, there is a law for regulating
12 liquidity quotas. This law was not enforced, however,
13 as the banks preferred to accept this more flexible
14 method of voluntary agreements, or recommendations from
15 the side of the Riksbank.

16 It should be observed that "liquidity" ratios
17 recommended to the commercial banks have a wider content
18 than the corresponding Canadian concept. It includes
19 long-term Government bonds as well as bonds issued by
20 Government mortgage institutions. It is clear from
21 this wide concept of "liquidity" that the Swedish type
22 of restrictive credit policy is combined with important
23 elements of Government direction of saving funds for
24 special high priority uses. (Government and house
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27 There is no doubt that the combination of
28 monetary and fiscal policy measures (including a rise
29 in corporation taxes) had considerable dampening effects
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2 industry and trade kept nearly constant during the three
3 years - a quite remarkable feature during a period with
4 very profitable investment opportunities. The volume of
5 investment in private industry also kept stable around
6 the 1954 level. According to extensive interview studies
7 carried out during 1955 and 1956, actual investment
8 expenditures had been reduced by about 15 per cent
9 below the plans existing at the end of 1954. This
10 restrictive effect could be explained both by the
11 investment fee and by the credit rationing, while the
12 rise in the level of interest naturally played a minor
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15 This achievement of effectively dampening
16 investment activity during an international boom is
17 especially remarkable when looking at the boom in
18 private investment that came about in Sweden during the
19 recession of 1958-59. During these years, investment
20 in industry increased by 10-15 per cent per year - and
21 had in 1961 reached about 60 per cent above the 1957
22 level. This anti-cyclical development must, to a large
23 extent, be attributed to the quick relaxation of policy
24 restrictions that was carried out from the beginning of
25 1958. The investment tax was abolished, the level of
26 interest rates lowered and credit restrictions abolished
27 (except for the issue control). The investment projects
28 that had been postponed and accumulated during the boom
29 years apparently could now more easily and cheaply be
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1 of the investment cycle, also ought to have had good
2 effects on the profitability of investments; costs
3 were lower, building materials and labour more easily
4 available during 1958-59 than if the investments had
5 been made during the boom years of general excess
6 demand. One necessary condition for this relative
7 success with the stabilization policy during these
8 years was of course that the longer-term prospects of
9 industry seemed promising. That was apparently the
10 case. Expanding public works (with large Government
11 budget deficits) and housebuilding during 1958-1959
12 contributed to this effect.

13
14 However, there are also dis-economies related
15 to an effective stabilization policy. In a way, the
16 Swedish authorities in those years carried out a rather
17 clumsy and awkward economic policy. The Government was
18 more or less continuously creating liquidity at a too
19 rapid rate and the Central Bank had, by special restric-
20 tive methods, to sterilize most of this liquidity. The
21 type of intensive credit restrictions and regulations
22 that were in force may have had bad effects on the
23 allocation of resources. Strict rationing of resources
24 usually has effects of this nature. The costs of capital
25 - interest rates paid on grey or black credit markets
26 and imputed yields on scarce funds - seem to have had
27 a large dispersion as between firms during these years.
28 Such disparities imply bad functioning of the markets
29 for savings and ineffective allocation of capital
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1 insignificant during short periods of restrictive
2 policy - but may be serious over longer periods of
3 repeated manoeuvres of this type. However, we have
4 no possibilities of measuring this kind of productivity-
5 dampening effects.

6
7 During the next boom, from the fall of 1959,
8 the restrictive policies were, as mentioned above, quite
9 different. The main difference refers to active and
10 successful attempts to mop up surplus liquidity, in order
11 to create a more general monetary stringency than during
12 the 1950's. The Government carried out extensive open
13 market operations outside the banking system. New taxes
14 (a general purchase tax of 4 per cent was introduced) and
15 more restraint on Government expenditures, resulted in
16 an elimination of the budget deficit. The policy was
17 effective in mopping up surplus liquidity also outside
18 the banking system. The interest rates on treasury bills
19 were raised radically from 1959 to 1960, making it
20 profitable for corporations to shift surplus funds over
21 from bank deposits to treasury bills.

22 The very restrictive monetary policy that
23 was carried out during the years 1960 and 1961 implied
24 a severe pressure, especially on the commercial banks.
25 They were partly unable to reach the liquidity ratios
26 prescribed, and had during some periods to borrow
27 heavily from the Riksbank. It is remarkable, however,
28 how slow the effects seemed to be on the actual develop-
29 ment of bank advances - in contrast to the experiences
30 during the period 1955-57 of drastic credit restrictions.



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1 There seems to have been no effective dampening of
2 industrial investments; in fact, the volume of invest-
3 ment expenditures in industry expanded by 30 per cent
4 from 1959 to 1961. This result may, however, be taken
5 as partly intended. A high volume of investment in
6 various branches of industry was highly needed in view
7 of the changing structure of production expected to
8 follow the new developments on the Western European
9 markets. Severe restrictions on Government expenditures,
10 and to some extent on private consumption (a general
11 purchase tax), were important complements to the monetary
12 policy during these last years.

13
14 5. The Investment Reserve Technique

15 It should be added to the previous paragraph that
16 a specific Swedish policy invention - the investment
17 fund or reserve method - also had considerable liquidity
18 absorption effects during the years 1960-1961. As this
19 instrument of economic policy may be of special interest,
20 I shall, herein, give a general presentation of its
21 construction.

22 There are, since a number of years, possibilities
23 for Swedish corporations to make tax-free allocations to
24 so-called investment reserves and to use these reserves
25 during special years of low activity. The purpose is
26 to stabilize investments in building, machinery and
27 inventories over the cycle. During a boom, companies
28 may thus set aside from their profits an investment
29 reserve which is carried in the books on the liabilities'
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There seems to have been no effective dampening of investment in industry expanded by 50 per cent from 1959 to 1961. This result may, however, be taken as partly intended. A high volume of investment in various branches of industry was highly needed in view of the changing structure of production expected to follow the new developments on the Western European markets. Severe restrictions on Government expenditures and to some extent on private consumption (a general purchase tax), were important complements to the monetary policy during these last years.

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1 profits otherwise liable to taxation. When, in some
2 later year, the authorities regard the economic
3 situation as needing some stimulus, these reserves may
4 be released wholly or in part for the immediate writing
5 down of certain types of investment expenditures incurred
6 during the year. Expressed in a very general way, this
7 device means that corporations during boom years with
8 high profits can set aside investment funds (up to a
9 certain per cent of profits) as a writing down of
10 investment expenditures that will be made during later
11 years of low activity, when the National Labour Market
12 Board gives a general or specific allowance. The
13 stimulus to extra high investments (especially in
14 machinery) during boom years with high profits, that the
15 generous depreciations allowance system in Sweden implies,
16 may in this way be effectively reduced. In order to
17 eliminate the liquidity effects of the investment funds
18 that are set aside, a certain part (corresponding to
19 corporation taxes that otherwise had to be paid) has
20 to be deposited, (without interest yield), in the
21 Riksbank. An extra stimulus to use this device is given
22 by a 10 per cent deduction from taxable profits of the
23 investment fund used. The Labour Market Board determines
24 when the investment funds can be used for writing-off
25 purposes and also specifies the conditions, e.g. the
26 period when the investment expenditures should take
27 place. When the funds are used, the deposits at the
28 Riksbank are released to a proportional extent.

29
30 The investment fund technique has been applied



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may in this way be effectively reduced. In order to
eliminate the liquidity effects of the investment funds
that are set aside, a certain part (corresponding to
corporation taxes that otherwise had to be paid) has
to be deposited, (without interest yield), in the
Riksbank. An extra stimulus to use this device is given
by a 10 per cent deduction from taxable profits of the
investment fund used. The Labour Market Board determines
when the investment funds can be used for writing-off
purposes and also specifies the conditions, e.g. the
period when the investment expenditures should take
place. When the funds are used, the deposits at the
Riksbank are released to a proportional extent.



1 with success since 1957. During 1958-59, the Labour
2 Market Board gave allowance to use investment funds set
3 aside during earlier years, in order to stimulate building
4 activity. Funds of considerable size were used during
5 this time. This policy seems to have contributed
6 effectively to the investment boom during the recession.
7 However, there has been some criticism to the effect
8 that the stimulus from the use of investment funds came
9 too late so that the investment boom of 1960 was
10 aggravated. The Labour Market Board has now tried to
11 avoid this difficulty with time lags - that in fact is
12 common to all policy methods - by reacting in an antici-
13 patory way during this current year. Some slack in
14 activity is expected during the winter season 1962-63
15 and, in May this year, the Board has therefore already
16 announced the possibility of using investment funds
17 during this period.

18
19 As mentioned above, the investment fund technique
20 not only means stimulus to investment during recession
21 periods, but should also have a braking effect during
22 booms. This latter effect refers both to postponement
23 of investments and to liquidity absorption. A special
24 method was applied during 1960 and 1961, to stimulate
25 corporations to "sterilize" parts of their liquidity
26 surplus, by making it very profitable for them to
27 deposit 100 per cent of the investment reserve set aside
28 with the Riksbank (and not only the tax equivalent).
29 This possibility was extensively used, thereby
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1 It is of interest to note that the Swedish Government
2 has considerable confidence in the technique of invest-
3 ment reserves as a method of investment stabilization.
4 Earlier - not least in the 1930's - there was much
5 belief in anti-cyclical public works as the main
6 instrument. Experience has shown how difficult it is
7 to build up, renew and use a considerable reserve of
8 public investment projects and get a good timing of
9 expenditures relating to the short recessions that the
10 Swedish economy has so far experienced.

11 The application of investment taxes and credit
12 rationing - and corresponding releases of these
13 applications - are certainly effective weapons, but tend
14 to work by chock and be disturbing on private enterprise.
15 The system of investment reserve allowances works
16 elastically and rather quickly, because it is built on
17 a basis of voluntary participation of the individual
18 companies and refers to well-prepared projects. That
19 measure just gives a location in time that is desirable
20 from a stabilization point of view. In a way, the
21 system combines the advantages of centralized government
22 planning with decentralized initiative and private
23 knowledge of the merits of each project. The policy
24 certainly involves a considerable element of investment
25 subsidy (in the form of tax allowances) but it is a
26 subsidy given on reliable conditions that the investments
27 will really be made and imply effective incentives for
28 productive developments. In contrast to the various
29 measures of restriction that the Government has been
30



1 experimenting with during the last decade, the
2 technique of investment reserves is a very popular
3 device among businessmen.

4
5 6. Can Swedish policy experiences be useful from
6 Canada's point of view?

7 It is not possible for me to judge very well
8 to what extent and in what ways the Swedish experiences
9 may be useful from the Canadian point of view. There
10 are always great dangers in transferring experiences
11 from one country to another.

12 It is clear that in some respects the stabil-
13 ization policies in Sweden have not been successful.
14 That refers especially to the rapid rise of prices and
15 wages. The monetary policy carried out has been very
16 uneven and experimental. A long period of passivity
17 with a $3-3\frac{1}{2}$ per cent level of long-term interest rates
18 was followed from 1954 by ambitious credit restriction
19 policies under conditions of excess liquidity and
20 scarcity of long-term capital, (with long-term interest
21 rates reaching around 5-6 per cent), after which came
22 the last phase characterized by a remarkable scarcity
23 of liquid funds. Not least, the commercial banks have
24 had great difficulties in adjusting to the rapid shifts
25 in policy. There is no doubt, however, that the
26 restrictive monetary policy measures have had dampening
27 effects on the investment booms - and corresponding
28 stimulus in recessions. On the other hand, we cannot
29 measure, only guess, that this type of policy has had
30 some bad consequences as to the allocation of capital
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1 activity in a very uneven way.

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3 It is plausible that monetary policy in Sweden
4 has now reached a more balanced stage. There are much
5 better general conditions for effectiveness. The
6 Government budget is in close balance at the same
7 time as the rapidly rising and already large General
8 Pension Fund (a big pension reform was decided in
9 1960), giving a strong support to a restrictive fiscal
10 policy. The possibilities of self-financing for
11 corporations in private industry has been reduced
12 and will probably continue to be much less than
13 during the 1950's. These factors will imply greater
14 dependence of private firms on the credit market -
15 and will therefore give monetary policy a more
16 strategic position than before. Under these conditions,
17 it may be possible to reach considerable stabilizing
18 effects without the need of the rather drastic
19 measures tested during the past decade. The relatively
20 high level of interest rates reached for long-term
21 Government bonds - as contrasted to the situation at
22 the beginning of the 1950's - is an indication of a
23 realistic adaptation to the underlying scarcity
24 conditions of savings.

25 It should be added that I have not tried to
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1 rates give potential instruments in the hands of the
2 Riksbank, to be used in situations where the more
3 orthodox means seem insufficient to govern the
4 development of the credit and capital markets. As a
5 curiosity - but also as an indication of the "spirit
6 of interference" - I may mention that the law for
7 regulating interest rates contains provision for
8 setting both maximum and minimum rates on bank deposits.
9 The hard competition between the different types of
10 banks for the scarce savings funds tends to take the
11 form of raising the interest rates - and this, especially
12 during times of restrictive monetary policy. The law
13 has never been enforced but is there in the background
14 as a condition for voluntary agreements to prevent an
15 upward slide of interest costs.

16
17 There has been relatively good success with
18 policy measures aiming at counteracting recessionary
19 tendencies. In a way, this has been an easier part of
20 policy than the restriction problem during inflationary
21 booms. During the short recessions, originating in
22 demand for exports and disaccumulation of inventories,
23 the expansionary forces of incomes, consumption,
24 government expenditures and parts of fixed investments
25 have been strong - partly being postponement effects
26 from the dampening down of investments during the
27 previous boom. The Government plan of reserving public
28 works for periods of slack activity has played a role
29 but has not been an important factor of stabilization.
30 Yet, the full employment ambitions have reached such

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5 stabilization results were not bad: the rate of growth
6 of total production was just retarded to 1 per cent in
7 1958 in spite of a decline in the volume of exports and
8 a substantial inventory dis-investment.

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10 One good side of the stabilization policies
11 carried out in Sweden during the post-war period has
12 been that it has not resulted in longer periods of
13 retarded growth as in several other countries. It
14 should be remembered, however, that the stabilization
15 policy job has been easier than in countries like
16 Canada, Holland, Denmark and U.K. because of the fact
17 that there has been no exchange difficulties since 1947.
18 This fact in turn can only indirectly and to a limited
19 extent be related to current economic policy. Certainly
20 the devaluation of the Sw. Crown in 1949 (following the
21 English pound) meant a considerable undervaluation that
22 gave sufficient "international space" for a rapid
23 internal expansion.

24 When looking at Canada's economic problems
25 from the point of view of the Swedish experiences as
26 summarized here, my main impression of difference refers
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28 The policy problems have certainly been very different
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When looking at Canada's economic problems from the point of view of the Swedish experiences as summarized here, my main impression of difference refers to the slow economic development in Canada since 1950. The policy problems have certainly been very different during this period. In Sweden, the problem has mainly been to prevent total demand (for investment and



1 consumption) from expanding too rapidly. For Canada,
2 the problem is rather how to give the economy a
3 stronger push from the demand side. In Sweden, the
4 push on total demand has mainly come from rising exports,
5 fixed investments and Government expenditures - in such
6 proportions, by happy coincidence, that exchange
7 difficulties have been avoided. As a very approximate
8 comparison of the relative strength in these "push
9 factors", I may mention that the sum of exports, fixed
10 investment and Government expenditures, measured in
11 relation to GNP (all in real terms) over the period
12 1948-60 have been increasing by a little more than 2
13 per cent per year in Canada and by close to 4 per cent
14 in Sweden. From 1956, the difference in the rate of
15 growth of the push factors (in relation to GNP) is
16 much larger: hardly any increase at all in Canada and
17 4.3 per cent per year in Sweden. From the point of view
18 of economic policy, I consider this absence of "demand
19 push" during the last period, a central issue in Canada.

20
21 In the present stage of the world markets
22 for most of Canadian export goods, with special reference
23 to the sluggishness of the U.S. economy, it is certainly
24 not easy to "arrange" a strong and lasting push on the
25 economy from expanding exports. If - as may be natural
26 from a Swedish point of view - we take rapid growth in
27 national income and productivity and full employment as
28 being of primary importance to the health of the economy,
29 certain risks must be taken with regard to the value of
30 money and the balance of payments situation. From the



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1 long-term point of view, a relatively small economy
2 like the Canadian economy, must, if possible, avoid
3 import restrictions and other forms of strong protection.
4 An expansionary policy is not inflationary if the
5 increase of total demand is matched by elastic supply
6 conditions determined by unused capacities of labour
7 and capital. Of course, such a policy would be relatively
8 easy and more or less automatic if there was a simultan-
9 eous rapid expansion of the U. S. economy. The
10 difficulties with the Canadian balance of payments, that
11 will arise if this condition should not be fulfilled,
12 may be exaggerated however. Rapid expansion of the
13 Canadian economy - corresponding to the pattern of the
14 post-war years up to 1957 - would imply increasing needs
15 of new investments and therefore high profitability
16 in promising branches of activity. One consequence
17 of this would again be rising influx of U.S. capital
18 in the form of direct investments - perhaps covering
19 the deficit of the current balance of payments that
20 would be due to rising imports of capital goods.

21
22 Certainly, this is a very general and
23 perhaps also fairly irresponsible type of policy
24 suggestion coming from a foreigner not knowing much
25 about the political as well as economic possibilities
26 in Canada. Anyhow, quite specific suggestions of
27 policy strategy are necessary in order to make such a
28 general approach to an expansive policy realistic.
29 I can imagine that one necessary condition for giving
30 "international space" (of the Swedish case) to such a

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1 policy might be a further devaluation of the Canadian
2 dollar. Good arguments as to the existence of a
3 potential fundamental dis-equilibrium in the balance of
4 payments at full employment and rapid growth can
5 probably be presented. The rise in the cost of living,
6 following a devaluation, need not be considerable -
7 under the assumption of rapidly rising productivity
8 as a consequence of the expansion of total demand and
9 the prevailing very competitive conditions on the
10 world markets. It was certainly quite another thing
11 to devalue the currencies in 1949 just prior to the
12 Korean inflation.

13
14 In waiting for an expansionary boom of
15 Canadian exports, the demand push may have to begin
16 with an expansive fiscal policy, (more rapidly growing
17 Government expenditures at given or lower tax rates).
18 It is easy to say that monetary policy should support
19 an expansive policy of this type, implying that interest
20 rates should be kept as low as the balance of payments
21 restrictions allow. But it is impossible for an out-
22 sider to be more specific as to the measures actually
23 needed. It may perhaps be added that if an expansive
24 general policy becomes effective, it may be necessary
25 to shift to a restrictive monetary policy and take
26 account of a potential capital scarcity also in Canada
27 just as in Sweden. This just means that monetary
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1 how much of Swedish policy instruments in modified
2 editions could be tried in Canada. In a way, lessons
3 from Sweden could only be directly helpful under the
4 condition that Canada reached close to full employment
5 under rapid growth and had to manage recurrent
6 inflationary booms. I imagine that the lessons of
7 rather drastic credit and fiscal restriction measures
8 might then be helpful. The "productivity friendly"
9 type of Swedish investment reserve policy may be
10 something to consider in some revised form, fitting
11 into Canadian taxation conditions. At last, I would
12 especially like to refer to the positive Swedish
13 experiences of an active labour market policy. Rapid
14 expansion of productivity under high and rising
15 employment presumes continuous changes in the economic
16 structure. Factors of production have to shift
17 extensively and smoothly from contracting and stagnating
18 firms and branches of activity to the growth sectors
19 of the economy. High demands are raised not only on
20 the effective functioning of credit and capital markets,
21 but also on the mobility of the labour force. This
22 expression does not only refer to geographical mobility
23 and mobility between branches of industry, but also to
24 mobility between skills. Vocational training schools
25 and programs, within and outside the companies, are
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Nethercut & Young

Toronto, Ontario

A. 29

1 laid on the efficient functioning of the labour market
2 and on the adaptability of labour to changing demands
3 as strategic factors of economic growth.
4
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7 Stockholm,
8 August 13, 1962

Erik Lundberg.

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2. 29

laid on the efficient management of the labor market
and on the organization of labor in various branches
as a result of the work of the Commission

Stockholm, Sweden
January 12, 1922

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